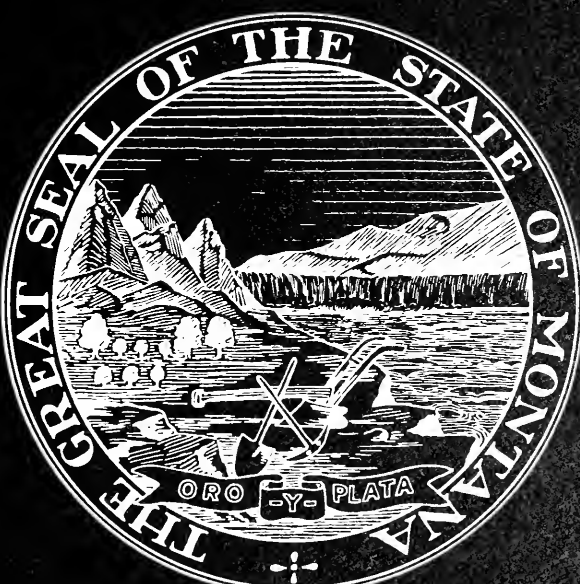
TAX EXPENDITURE REPORT FOR THE STATE OF MONTANA



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Prepared for:

THE 1995 MONTANA LEGISLATIVE SESSION

per

STATUTE: 15-1-205, MCA

Montana Department of Revenue
Helena, Montana

January, 1995

State of Montana
Marc Racicot, Governor

Department of Revenue
Mick Robinson, Director

P.O. Box 202701
Helena, Montana 59620-2701

LETTER OF TRANSMITTAL

Governor Marc Racicot and
Members of the Fifty-Fourth Montana Legislature:

I am transmitting the Tax Expenditure Report of the Department of Revenue as specified in 15-1-205, MCA. This is the fourth tax expenditure report prepared for the State of Montana, and provides estimates for the time period July 1, 1995 through June 30, 1997 (FY 1996 and 1997).

I hope you find this information useful in your tax policy deliberations.

Respectfully submitted,

Mick Robinson
Director

PREFACE

House Bill 387, passed by the Fiftieth Legislature (1987), amended MCA 15-1-205 by suggesting that the Department of Revenue supplement its Biennial Report with estimates of revenue losses attributed to certain deductions, exclusions, credits, and other preferential tax treatment of income or property.

The objective of this report is to provide that information as a useful tool to the Governor and the Legislature for developing tax policy. Clear information on the costs of tax deductions and exemptions is as important as accurate data on costs of government services. Every effort was made to produce as comprehensive, detailed, and accurate a report as possible. The report encompasses changes in tax law through the Fifty-Third Montana Legislature (including special sessions), and incorporates changes embodied in the Federal Tax Reform Act of 1986, and the Omnibus Budget Reconciliation Acts of 1990, and 1992.

This is the fourth edition of this report. Future editions will refine the information provided, and reflect continued enhancements in statistical and computational estimating methods. In this regard, any critiques or recommendations would be gratefully acknowledged and welcomed. Please send any comments and questions to:

Montana Department of Revenue
Office of Research and Information
Room 480, Mitchell Building
Helena, Montana 59620

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INTRODUCTION

Once every two years the Montana Legislature convenes in regular session to fulfill its responsibilities in the functioning of state government. Basic responsibilities include the review of past budgets associated with alternative government spending programs, a determination of the appropriateness of continuing these programs, the budgeting of program expenditure levels for coming years, and the appropriation of funds needed to finance continued and additional programs.

In recent years, attention has begun to focus on the fact that in this review process most state legislatures (Montana's included) systematically overlook a major component of government finance. This component consists of the reductions in state revenue attributable to deductions, exclusions, credits, and other preferential treatment in the tax code. In effect, the specific deductions, exclusions, credits, and other preferential items currently in tax codes, represent indirect government spending programs, in the sense that these same preferences result in foregone revenue that otherwise would have been available for direct expenditure programs. Hence, these items are commonly referred to as "tax expenditures".

This introductory section examines the tax expenditure concept, discusses methods used in measuring tax expenditures, provides some caveats in the use of tax expenditure estimates, examines the history of tax expenditure reporting, and presents a verbal outline of this report.

THE TAX EXPENDITURE CONCEPT

Tax expenditures are defined as provisions of the tax code that provide for special exclusions, exemptions, deductions, credits, deferrals, or preferential tax rates that result in foregone revenue.

The purpose of tax expenditures is to provide *financial assistance* to certain groups of taxpayers, or to provide an *economic incentive* that encourages specific taxpayer behavior. One example of a tax expenditure designed to provide financial assistance is the additional personal exemption allowed the blind and/or elderly. On the other hand, the deduction allowed homeowners for mortgage interest may be viewed as an inducement to encourage home ownership. In both cases, the same objectives could be met through direct government spending programs that subsidize certain individuals on the basis of specific characteristics or behavior.

Tax expenditures arise as a consequence of deviations from the "normal" tax structure. There is no general consensus regarding *the* normal income tax structure. However, there are a few tax provisions that are generally agreed upon to be components of the normal tax structure, and consequently are not considered tax expenditures here as well. These items include:

1) the standard deduction,
2) the personal exemption allowed each taxpayer and each dependent,
3) the progressive rate structure based on ability to pay, and
4) the deduction for costs incurred in producing income.

Other provisions which remain the subjects of vigorous debate, but which nevertheless are considered by most to be components of the normal tax structure, include:

1) unrealized appreciation in asset values,
2) imputed income from homes and other assets, and
3) indexing the tax structure for inflation.

In Montana, two-earner married households are still allowed the option of filing separate returns without the penalty of having to use a different tax table for this form of filing. Given the relatively few states (10) that still allow this option, this is now considered to be a tax expenditure item for Montana.

In addition to the rate table advantage, married couples who file separately may allocate certain items of income in a manner advantageous to reducing their tax liability.

The following schedule shows the actual revenue loss attributable to this expenditure item for tax years 1990 through 1993, and the projected tax expenditure for fiscal years 1996 and 1997:

Tax Year	Tax Expenditure
1990	$ 29,363,000
1991	$ 30,857,000
1992	$ 35,051,000
1993	$ 32,667,000
FY96	$ 34,000,000
FY97	$ 35,500,000

Generally, state tax expenditure reports do not include provisions of tax law that lie beyond the state's legal jurisdiction. For example, federal statutes and court rulings prohibit states from taxing certain railroad retirement benefits, and income earned by Indians on reservations. Tax law provisions of this nature are not reported here.

At the state level, tax expenditures may be "passive" or "non-passive" in nature. Passive tax expenditures occur when a state ties its tax code to the federal tax code in a manner that allows for the automatic incorporation of federal changes into state law.

For example, for state income tax purposes the starting point for determining Montana taxable income is federal adjusted gross income (FAGI). By starting with FAGI, Montana automatically incorporates the exclusions (e.g., employee fringe benefits) and deductions (e.g., IRAs) used in arriving at FAGI. These exclusions and deductions constitute passive tax expenditures at the state level. The federal Tax Reform Act of 1986 eliminated or curtailed several tax expenditure items at both the federal level and for Montana. Nevertheless, most of the tax expenditures reported herein are passive in nature.

MEASURING TAX EXPENDITURES

Two methods were used to estimate the value of tax expenditures in this report. The first method, used to estimate passive (federal) provisions of the individual income and corporation license tax, allocates a portion of national estimates to Montana. Every year the federal Joint Committee on Taxation publishes its estimates of federal individual and corporate income tax expenditures for selected fiscal years. These estimates can then be allocated to states on the basis of relative total tax and tax rates at the national and state level.

Although this method is used by most states for deriving at least some of their tax expenditure estimates, it is also recognized as being a relatively crude estimating technique. For the individual income tax, it assumes that Montana's demographic characteristics (e.g., age and income distributions) and mix of industries are the same as those of the nation, and that Montanans' consumption and expenditure patterns parallel those nationally. Obviously, this is an oversimplification.

This simple approach results in an understatement of tax expenditures for industries like agriculture and mining, which are more important to Montana's economy than to the U.S. economy. Because of this, allocations based on sector specific earnings data were used to estimate tax expenditures specifically related to these two industries.

To an extent the problem is lessened for the corporation license tax because taxable incomes and tax rates are available by major industrial sectors at both the federal and state levels. Nevertheless, estimates derived using this method still should be regarded as imprecise, and perhaps used only to gauge the relative magnitudes of different expenditure items.

The second method uses actual data available at the state level together with computer simulation modeling to produce much more reliable estimates of the impacts of certain tax expenditure items. This method was used to derive the estimates for Montana-specific reductions to income, itemized deductions, and credits for the individual income tax; credits for the corporation license tax; and all expenditure items reported for natural resources and property tax.

USING TAX EXPENDITURES - SOME CAVEATS

In most cases tax expenditure estimates should be viewed as a measure of the amount of relief, assistance, or subsidy currently being provided through tax codes, and **not** as the amount of revenue that would be gained by repealing expenditure provisions of tax law. There are several reasons for this.

First, estimates of tax expenditures are made in the absence of any assumptions regarding *policy responses*. For example, employer contributions for medical insurance premiums and medical care are currently excluded from the employee's reported income. Some may view the tax expenditure associated with this item as a measure of the revenue that would be gained by requiring employees to include this contribution in their incomes. However, in keeping with

current policy, employees who itemize deductions might be allowed to include all or part of this contribution in their personal deduction for medical expense if this exclusion were repealed. A policy response of this nature would reduce the tax expenditure associated with this item considerably.

Second, tax expenditures are not additive. In other words, the revenue effect of rescinding *all* tax expenditure items cannot be estimated simply by adding the tax expenditures associated with each individual tax expenditure item. This is because many of the tax expenditure items are interrelated, and a simple sum of tax expenditures estimated in isolation does not take into account these *interaction effects*.

Furthermore, because each tax expenditure is measured in isolation, a simple summing of tax expenditures will bias the total effect downwards in the presence of a *progressive tax rate schedule*, such as the one used in Montana. If all tax expenditures were eliminated simultaneously, taxable incomes would rise much higher than if a single expenditure provision were eliminated, subjecting taxable incomes to higher marginal tax rates.

Third, tax expenditure estimates do not take into consideration taxpayer *behavioral responses*. For example, it is quite conceivable that eliminating the deduction for charitable contributions would substantially reduce the number and size of these contributions. Taxpayers may funnel these funds into other tax saving devices, thereby reducing the revenue gain estimated in the absence of any behavioral response.

Given these considerations, users should view tax expenditure estimates more as a measure of the amount of relief currently being provided, rather than as a measure of the revenue that could be generated from repealing the associated tax provision.

TAX EXPENDITURE REPORTING

Tax expenditure reporting and tax expenditure budgets are a relatively recent phenomenon. The earliest record of reporting government subsidies administered through the tax code is in the Federal Republic of Germany, in 1959.

In the U.S., the pioneering work of Stanley Surrey lead to the first federal tax expenditure budget, prepared by the Department of Treasury, in 1967. In 1971, California became the first state to adopt legislation requiring tax expenditure reports. California was followed by Wisconsin in 1973, and by Maryland and North Carolina in 1975. Today, at least half the states regularly publish comprehensive or partial tax expenditure reports.

In almost all cases, tax expenditure reports and budgets are prepared in response to a statutory requirement. Usually, the statutes spell out the type of information the report is to contain, and the time period to be covered.

HB387, passed during the 1987 regular session, provides that the Department of Revenue's

Biennial Report may include specified information relating to tax expenditures. The bill did not contemplate a specific time period for these expenditures. However, the bill did specify that the report may include tax expenditures attributable to:

1) personal income and corporation license tax exemptions,
2) property tax exemptions for which application to the Department or its agent is necessary,
3) deferrals of income,
4) credits allowed against Montana personal income tax or Montana corporation license tax,
5) deductions of income, and
6) any other identifiable preferential treatment of income or property.

In addition, the Department was directed to provide:

1) distributions of tax expenditures across age and income brackets, whenever available,
2) any known purpose for the preferential treatment, and an outline of available data necessary to determine the effectiveness of the preference, and
3) similar information from other states, if available.

OUTLINE OF THIS REPORT

The following sections of this report discuss tax expenditures associated with the individual income tax, the corporation license tax, natural resources taxes, and the property tax. Almost all of the tax expenditure items reported here reflect a consensus of other states and the federal government. Additional items and information, which may not ordinarily be considered in tax expenditure reports, are included because of statutory requirements.

For each tax, a brief overview defines the tax base, and other pertinent information. The second part provides the detail, including a description and a purpose for each expenditure item. As discussed earlier, there are two general purposes for tax expenditures: to provide financial assistance (economic relief), or to provide a financial incentive to encourage specific taxpayer behavior. In some cases it was possible to elaborate further on the purpose of the expenditure.

The following sections of this report include all tax expenditures estimated for Montana. Selected individual income tax expenditures by decile grouping income brackets can be found in the appendix.

CONCLUDING REMARKS

Although a relatively recent phenomenon, tax expenditure reporting and tax expenditure budgets are becoming more and more prevalent at the state level.

As states adopt tax expenditure reporting, legislators and administrators would be well advised to keep the limitations of tax expenditure reports in perspective. Tax expenditure estimates are not estimates of the amount of revenue that would be generated by repealing the associated tax provision, but rather estimates of the amount of relief currently being provided through the tax code. These estimates are subject to several methodological ambiguities, and in some cases severe data limitations.

Tax expenditure reports and budgets are primarily designed to be informational tools. Nothing in these reports is intended to convey a judgment regarding the propriety of various tax provisions. Tax expenditure reporting may encounter widespread resistance if opponents view the process as a means of selecting provisions for repeal in order to enhance revenues. Nevertheless, when used appropriately, the tax expenditure report or budget can be a valuable tool in providing lawmakers with added insight into the extent and distribution of governmental assistance.

INDIVIDUAL INCOME TAX

OVERVIEW AND SUMMARY

The starting point for calculating Montana individual income tax is federal adjusted gross income (FAGI). Montana-specific additions and reductions to income determine the taxpayer's Montana adjusted gross income (MAGI). Either itemized or standard deductions and allowable taxpayer exemptions are subtracted from MAGI to arrive at the tax base, Montana taxable income (MTI).

A single tax table used by all filers, is applied to taxable income to arrive at tax before credits. In applicable years this amount is adjusted for any surtax in effect and any tax on lump sum distributions that the taxpayer may have. This amount is then reduced by any income tax credits the taxpayer may have, to arrive at tax after credits.

The income tax base, and net tax liability may be summarized as follows:

	Income from all sources
Less:	federal exclusions, and federal deductions
Equals:	**Federal Adjusted Gross Income (FAGI)**
Plus:	Montana additions
Less:	Montana reductions
Equals:	**Montana Adjusted Gross Income (MAGI)**
Less:	deductions (itemized or standard), and exemptions
Equals:	**Montana Taxable Income (MTI)**
Times:	tax table
Plus:	surtax (in applicable years), and tax on lump sum distributions
Equals:	**Tax Before Credits**
Less:	credits
Equals:	**Tax After Credits**

When computing tax liability, all filers use the same tax table. Montana is one of 10 states where married couples may choose to file separate returns if both have income in the same year. The 1994 tax table is shown below:

If Taxable Income is:

Over	But not over	Then tax liability is		
$ 0	$ 1,800	2% of taxable income	less	$ 0
$ 1,800	$ 3,600	3% of taxable income	less	$ 18
$ 3,600	$ 7,200	4% of taxable income	less	$ 54
$ 7,200	$ 10,700	5% of taxable income	less	$ 126
$ 10,700	$ 14,300	6% of taxable income	less	$ 233
$ 14,300	$ 17,900	7% of taxable income	less	$ 376
$ 17,900	$ 25,100	8% of taxable income	less	$ 555
$ 25,100	$ 35,800	9% of taxable income	less	$ 806
$ 35,800	$ 62,700	10% of taxable income	less	$ 1,164
$ 62,700		11% of taxable income	less	$ 1,791

Indexing

Montana has provided for full indexation of its income tax since 1981. The effect of indexing has been to reduce both tax liability and tax expenditure amounts. Indexing is considered to be an integral part of the normal tax structure, and hence, is not considered to be a tax expenditure.

Sources of Tax Expenditures

There are four sources of tax expenditures in Montana's individual income tax. First, because Montana ties to the definition of federal adjusted gross income, all of the federal exclusions and deductions included in FAGI are also included in Montana adjusted gross income.

Second, Montana statutes provide for specific exclusions of certain types of income not provided for at the federal level.

The third source of tax expenditures includes the deductions for those taxpayers who file itemized returns. Most of these deductions are also tied directly to federal statutes. However, Montana also allows a deduction for federal income taxes paid during the tax year, a deduction for child care expenses incurred by certain families, and a deduction for long-term care insurance premiums.

The fourth source of tax expenditures includes Montana-specific tax credits.

Immediately following is the summary tax expenditure table, the section after that discusses in more detail these sources in order, and provides a brief description and purpose for each tax expenditure item.

SUMMARY OF INDIVIDUAL INCOME TAX EXPENDITURES

Exclusions from Federal Income (pages 14-30)

	Tax Expenditure Item	Fiscal Impact (thousands $) FY 1996	FY 1997	Biennium
1.	Net Exclusion of Pension Contributions and Earnings	48,690	51,640	100,330
2.	Contributions by Employers and Self-Employed for Medical Ins. Premiums and Medical Care	32,780	35,450	68,230
3.	Untaxed Social Security Benefits	23,430	24,410	47,840
4.	Workers' Compensation Benefits	14,920	15,560	30,480
5.	Individual Retirement Plans (includes IRAs, Keogh Plans)	12,730	13,370	26,100
6.	Untaxed Medicare Benefits	11,900	14,030	25,930
7.	Capital Gains at Death	10,160	11,100	21,260
8.	Deferral of Capital Gains on Home Sales	10,210	10,590	20,800
9.	Investment Income on Life Insurance and Annuity Contracts	7,500	8,170	15,670
10.	Miscellaneous Fringe Benefits	3,440	3,650	7,090
11.	Capital Gains on Home Sales for Persons 55 and Over	3,400	3,530	6,930
12.	Cafeteria Plan Benefits	2,840	3,250	6,090
13.	Veteran's Benefits and Services	2,190	2,270	4,460
14.	Benefits and Allowances to Armed Forces Personnel	1,710	1,710	3,420

Exclusions from Federal Income (pages 14-30)

	Tax Expenditure Item	Fiscal Impact (thousands $) FY 1996	FY 1997	Biennium
15.	Employer-Provided Group Term Life Insurance Premiums	1,350	1,390	2,740
16.	Income Earned Abroad by U.S. Citizens	1,080	1,130	2,210
17.	Deferral of Interest Earned on U.S. Savings Bonds	920	990	1,910
18.	Scholarship/Fellowship Income	470	520	990
19.	Employer-Provided Child Care	450	520	970
20.	Employee Meals and Lodging (Other than Military)	400	400	800
21.	Medical Care and Health Insurance for Military Dependents	380	410	790
22.	Cancellation of Indebtedness Income of Farmers/Ranchers	340	340	680
23.	Income Earned by Benefit Organizations	340	340	680
24.	Public Assistance Benefits	300	340	640
25.	Rental Allowances of Ministers` Homes	200	200	400
26.	Like-kind Exchanges	180	200	380
27.	Permanent Exemption from Imputed Interest Rules	140	140	280
28.	Deferral of Gain on Installment Sales by Non-Dealers	140	140	280
29.	Employer-Provided Accident and Disability Insurance	140	140	280

	Tax Expenditure Item	Fiscal Impact (thousands $) FY 1996	FY 1997	Biennium
30.	Education Savings Bonds	70	110	180
31.	Interest on Montana State and Local Government Debt	N/A	N/A	N/A
32.	Other Exclusions From Federal Income	300	300	600

Deductions from Federal Income (pages 31-37)

33.	Depreciation in Excess of Straight-line Depreciation	5,170	4,980	10,150
34.	Cash Accounting for Agriculture	680	680	1,360
35.	Parental Personal Exemption for Students Age 19 Through 23	610	610	1,220
36.	Excess of Percentage Over Cost Depletion	460	640	1,100
37.	Expensing Certain Agricultural Multi-period Production Costs	550	550	1,100
38.	Expensing Depreciable Business Property	310	220	530
39.	Expensing Multi-Period Timber Growing Costs	190	190	380
40.	Amortization of Business Start-Up Costs	140	140	280
41.	Expensing of Exploration and Development Costs	90	90	180
42.	Other Deductions from Federal Income	90	90	180

Montana Exclusions/Exemptions (pages 38-42)

	Tax Expenditure Item	Fiscal Impact (thousands $) FY 1996	FY 1997	Biennium
43.	Exempt Retirement Income	5,870	6,170	12,040
44.	Additional Exemptions for Age 65+, and for Certain Physically Challenged Persons	4,620	4,910	9,530
45.	Exempt Unemployment Benefits	2,580	2,540	5,120
46.	Interest Exclusion for Age 65+	1,950	2,040	3,990
47.	Capital Gains Exclusion	720	530	1,250
48.	Excluded Tip Income	550	590	1,140
49.	Other Montana Exclusions	17,700	19,180	36,880

Itemized Deductions (pages 42-47)

50.	Federal Income Tax Paid	108,120	115,210	225,330
51.	Home Mortgage Interest	31,940	33,110	65,050
52.	Contributions	16,820	17,800	34,620
53.	Real and Personal Property Taxes	14,590	15,490	30,080
54.	Medical and Dental Expense	9,950	10,610	20,560
55.	Miscellaneous Deductions	7,010	7,220	14,230
56.	Deductible Investment Interest	2,240	2,180	4,420
57.	Other Deductible Taxes	2,280	2,400	4,680
58.	Long-term Care Insurance	280	280	560
59.	Casualty/Theft Loss	130	120	250
60.	Child/Dependent Care	30	30	60

Montana Credits (pages 48-54)

	Tax Expenditure Item	Fiscal Impact (thousands $) FY 1996	FY 1997	Biennium
61.	Income Taxes Paid to Other States	7,700	8,500	16,200
62.	Elderly Homeowner/Renter Credit	6,000	6,500	12,500
63.	Rural Physician Tax Credit	350	350	700
64.	Contractor's Gross Receipts Credit	280	250	530
65.	Nonfossil Energy Systems Credit	250	200	450
66.	Investment Tax Credit	220	210	430
67.	Recycling Credit	200	200	400
68.	Energy Conservation Installations	150	150	300
69.	Montana Capital Company Credit	130	150	280
70.	College Contribution Credit	100	105	205
71.	Other Credits (see text in following section)	450	525	975

INDIVIDUAL INCOME TAX - EXCLUSIONS FROM FEDERAL INCOME

The following exclusions from federal income (items 1-32) are passive tax expenditures derived from federal tax laws. The use of federal gross income greatly simplifies the administration of the state tax code by use of similar definitions and tax forms.

1 NET EXCLUSION OF PENSION CONTRIBUTIONS AND EARNINGS

MCA 15-30-111

Description:

Employer and employee contributions to a qualified pension plan, as well as the earnings on the contributions, are excluded from gross income. Employer contributions are also deductible.

In reality, this does not represent an exclusion of income but a deferral of income because the contributions are taxed when received as benefits in later years. The fiscal impact shown reflects the expenditure associated with excluding current-year pension contributions and earnings, net of all taxed pension benefits and distributions. (For the additional tax expenditure associated with state level retirement exclusions, see item 43 below.)

Purpose:

This exclusion provides an incentive to provide compensation in the form of retirement plan contributions, rather than wages and salaries, and promotes income security during an individual's period of retirement.

Fiscal Impact:

FY 1996 . . . . $ 48,690,000
FY 1997 . . . . $ 51,640,000

2 CONTRIBUTIONS BY EMPLOYERS FOR MEDICAL INSURANCE PREMIUMS AND MEDICAL CARE

MCA 15-30-111

Description:

Employer contributions to employee health insurance plans, and reimbursements to employees for medical care are excluded from employees' gross incomes.

Purpose:

This provides an incentive for employers to provide compensation in the form of nontaxable health benefits, rather than taxable income, and promotes the expansion of comprehensive health care plans.

Fiscal Impact:

FY 1996	$ 32,780,000
FY 1997	$ 35,450,000

3 UNTAXED SOCIAL SECURITY BENEFITS

MCA 15-30-111

Description:

Most social security benefits are untaxed. However, beginning in 1984 the federal government began taxing a portion of social security benefits of taxpayers with adjusted gross incomes above $32,000 for married couples, and $25,000 for single filers. Starting in 1994 a second tier of taxation was added for taxpayers with income greater than $34,000 for single filers and $44,000 for married couples. Montana follows federal laws with respect to the taxation of social security benefits.

Contributions to the social security system come from a tax on employees' wages and salaries, employers' matching amounts, and earnings on the accumulated balance. The social security tax paid by employees, however, is applied only to the first $60,600 of wages (1994). Wages in excess of this amount are not subject to the social security tax. There is no ceiling on wages subject to a separate Medicare tax, however.

Purpose:

Basically this provision eliminates the double taxation of social security benefits. These benefits essentially represent a return of previous taxes, to tax them would result in a tax on a tax. Consequently, they are excluded from income.

Fiscal Impact:

FY 1996	$ 23,430,000
FY 1997	$ 24,410,000

4 WORKERS' COMPENSATION BENEFITS

MCA 15-30-111

Description:

Unless attributable to medical expense deductions taken in an earlier year, workers' compensation benefits are not included in gross income.

Purpose:

This provides financial assistance and income security to recipients of benefits.

Fiscal Impact:

FY 1996 . . . . $ 14,920,000
FY 1997 . . . . $ 15,560,000

5 INDIVIDUAL RETIREMENT PLANS (IRAs, KEOGH PLANS, ETC.)

MCA 15-30-111

Description:

Individuals who are not active participants in an employer-sponsored retirement plan can exclude up to $2,000 each for contributions to an Individual Retirement Account (IRA). A married individual with an unemployed spouse can exclude up to $2,250.

Individuals who are participants in an employer-sponsored retirement plan may exclude up to $2,000 for contributions to an IRA if they are single and adjusted gross income is less than $25,000, or married with income less than $40,000. The deduction is phased out for single taxpayers with incomes between $25,000 and $35,000 and for married couples with incomes between $40,000 and $50,000.

Self-employed taxpayers may exclude up to the lesser of $30,000 or 25% of compensation, for contributions to a self-employed (Keogh) retirement plan.

Purpose:

This provides an incentive to increase savings and investment.

Fiscal Impact:

FY 1996 . . . . $ 12,730,000
FY 1997 . . . . $ 13,370,000

6 UNTAXED MEDICARE BENEFITS

MCA 15-30-111

Description:

Medicare benefits are excluded from gross income.

Purpose:

This exclusion provides financial assistance to elderly individuals in need of medical services.

Fiscal Impact:

FY 1996 . . . . $ 11,900,000
FY 1997 . . . . $ 14,030,000

7 EXCLUSION OF CAPITAL GAINS AT DEATH

MCA 15-30-111

Description:

Accrued capital gains on property transferred at death are not included as income to the heirs or the estate.

Purpose:

This provides income tax relief to heirs and estates subject to inheritance and estate taxes.

Fiscal Impact:

FY 1996 . . . . $ 10,160,000
FY 1997 . . . . $ 11,100,000

8 DEFERRAL OF CAPITAL GAINS ON HOME SALES

MCA 15-30-111

Description:

If taxpayers sell their principal residence, and buy and use another as their principal residence within a period beginning 2 years before and ending 2 years after the date of the sale, the gain on the sale is excluded from gross income, when the cost of the new residence exceeds the adjusted selling price of the old. If the cost of the new residence is less than the selling price of the old, the gain is included to the extent of the difference.

Purpose:

This exclusion enhances labor mobility in situations where homeowners are required to move as a result of job transfers; it also allows homeowners to purchase more expensive homes without a tax penalty.

Fiscal Impact:

FY 1996 . . . . $ 10,210,000
FY 1997 . . . . $ 10,590,000

9 INVESTMENT INCOME ON LIFE INSURANCE AND ANNUITY CONTRACTS

MCA 15-30-111

Description:

Accumulated interest earned on the cash value of life insurance and annuity contracts is excluded from current income. Also, if an insurance policy is surrendered before death of the policyholder, only the excess of surrender value over premium payments is taxable. In addition, the insurance accumulated on annuity contracts is not taxable until the annuitant begins receiving payments on the contract.

Purpose:

Excluding this income provides an incentive for increasing the societal savings and investment pool. In the case of annuity interest, this exclusion prevents the taxation of income until it is constructively received.

Fiscal Impact:

FY 1996 . . . . $ 7,500,000
FY 1997 . . . . $ 8,170,000

10 MISCELLANEOUS FRINGE BENEFITS

MCA 15-30-111

Description:

Miscellaneous fringe benefits such as employee discounts, no-additional cost services, and de minimis (minimal value) fringe benefits such as free meals in subsidized cafeterias are excluded from gross income.

Purpose:

This exclusion provides an incentive that encourages the substitution of nontaxable fringe benefits for taxable wages and salaries. This provision also recognizes the significant administrative impracticalities associated with monitoring this type of income.

Fiscal Impact:

FY 1996 . . . . $ 3,440,000
FY 1997 . . . . $ 3,650,000

11 CAPITAL GAINS ON HOME SALES FOR PERSONS 55 AND OVER

MCA 15-30-111

Description:

Taxpayers age 55 or older are provided a one-time exclusion of up to $125,000 on the gain from the sale of their principal residence.

Purpose:

This provides financial assistance to homeowners age 55 or older who sell their homes, and reduces transactions costs in the transfer of certain assets.

Fiscal Impact:

FY 1996 . . . . $ 3,400,000
FY 1997 . . . . $ 3,530,000

12 CAFETERIA PLAN BENEFITS

MCA 15-30-111

Description:

Cafeteria plans allow participating employees to choose among several employer-provided fringe benefits, rather than accepting an employer-stipulated benefits package. "Qualifying benefits" are any benefits that are excluded from income by a specific provision of federal code including group life insurance, accident or health benefits, and selected other benefits. The value of the benefits provided under cafeteria plans is excluded from the employee's gross income.

Purpose:

This exclusion provides an incentive that encourages the substitution of nontaxable fringe benefits for taxable wages and salaries.

Fiscal Impact:

FY 1996	$ 2,840,000
FY 1997	$ 3,250,000

13 VETERANS' BENEFITS AND SERVICES

MCA 15-30-111

Description:

All benefits administered by the Veterans' Administration are excluded from a taxpayer's gross income.

Purpose:

This provides financial assistance to veterans, and an incentive for military participation.

Fiscal Impact:

FY 1996	$ 2,190,000
FY 1997	$ 2,270,000

14 BENEFITS AND ALLOWANCES TO ARMED FORCES PERSONNEL

MCA 15-30-111

Description:

The value of in-kind services (such as housing) received by military personnel are excluded from income. Also excluded are certain cash allowances, combat pay, and military discharge pay.

Purpose:

This provides an incentive that makes military service more attractive financially, and makes military pay more competitive with civilian pay scales.

Fiscal Impact:

FY 1996 . . . . $ 1,710,000
FY 1997 . . . . $ 1,710,000

15 EMPLOYER-PROVIDED GROUP TERM LIFE INSURANCE PREMIUMS

MCA 15-30-111

Description:

Employer-provided group term life insurance premiums are excluded from the employee's gross income to the extent that the premiums provide coverage of $50,000 or less. Premiums for coverage in excess of $50,000, less any contributions by the employee for such premiums, are included in gross income. Disabled terminated employees are not subject to the $50,000 limitation.

Purpose:

This exclusion provides an incentive for employers to give compensation in the form of nontaxable insurance rather than taxable wages and salaries; it also contributes to income security for survivors in the event of the employee's death.

Fiscal Impact:

FY 1996 . . . . $ 1,350,000
FY 1997 . . . . $ 1,390,000

16 INCOME EARNED ABROAD BY U.S. CITIZENS

MCA 15-30-111

Description:

The income of U.S. citizens, whose principal residence is in a foreign country, and who live outside the U.S. for at least 11 out of 12 consecutive months, or who have joint residency in another country, is excluded from taxation. The Tax Reform Act of 1986 placed a cap of $70,000 on this exclusion beginning with tax year 1986. The exclusion does not apply to federal employees, including military personnel.

Purpose:

This prevents the double taxation of income.

Fiscal Impact:

FY 1996 . . . . $ 1,080,000
FY 1997 . . . . $ 1,130,000

17 DEFERRAL OF INTEREST EARNED ON U.S. SAVINGS BONDS

MCA 15-30-111

Description:

Cash basis taxpayers who purchase Series EE 'discount' U.S. Government Securities or the old Series E bonds may defer reporting any interest until the year of final maturity of the bonds, or other disposition, whichever is earlier.

Purpose:

This deferral option is an incentive to purchase Series EE, U.S. Savings Bonds.

Fiscal Impact:

FY 1996 . . . . $ 920,000
FY 1997 . . . . $ 990,000

18 SCHOLARSHIP AND FELLOWSHIP INCOME

MCA 15-30-111

Description:

Students who are degree candidates can exclude scholarship and fellowship income if amounts are not compensation for services.

Purpose:

This provides financial assistance to college degree candidates.

Fiscal Impact:

FY 1996 . . . . $ 470,000
FY 1997 . . . . $ 520,000

19 EMPLOYER-PROVIDED CHILD CARE

MCA 15-30-111

Description:

The value of employer-provided child care, not to exceed the lesser of the employee's earned income or $5,000, is excluded from gross income.

Purpose:

This provides an economic incentive for employers to provide child care, and aides in the ability of parents to work outside the home.

Fiscal Impact:

FY 1996 . . . . $ 450,000
FY 1997 . . . . $ 520,000

20 EMPLOYEE MEALS AND LODGING (OTHER THAN MILITARY)

MCA 15-30-111

Description:

Meals or lodging furnished to employees and their families are nontaxable provided that 1)

they are furnished for the convenience of the employer, 2) in the case of meals, they are furnished on the employer's premises, and 3) in the case of lodging, employees are required to accept the lodging as a condition of their employment.

Purpose:

This exclusion enhances mobility of labor, and provides ease in administration.

Fiscal Impact:

FY 1996 . . . . $ 400,000
FY 1997 . . . . $ 400,000

21 MEDICAL CARE AND HEALTH INSURANCE FOR MILITARY DEPENDENTS

MCA 15-30-111

Description:

The value of medical care and health insurance for military dependents is excludable from income.

Purpose:

This provides an incentive that makes military service more attractive financially, and makes military pay more competitive with civilian pay scales.

Fiscal Impact:

FY 1996 . . . . $ 380,000
FY 1997 . . . . $ 410,000

22 CANCELLATION OF INDEBTEDNESS INCOME OF FARMERS AND RANCHERS

MCA 15-30-111

Description:

Reduction of debt is considered income because it makes available assets previously offset by obligations. Generally, cancellation of indebtedness is included in income in cases where the debtor is solvent, but excluded from income in cases where the debtor is insolvent, up to the amount of insolvency. The Tax Reform Act of 1986 provides that under certain circumstances discharge of debt of a solvent farmer/rancher may be treated as if the farmer

or rancher were insolvent.

Purpose:

This measure provides a means of alleviating the credit crisis in the farming and ranching community, while allowing farms/ranches operating at the margin to continue operating.

Fiscal Impact:

FY 1996 . . . . $ 340,000
FY 1997 . . . . $ 340,000

23 INCOME EARNED BY EMPLOYEE BENEFIT ORGANIZATIONS

MCA 15-30-111

Description:

Voluntary employees' beneficiary associations (VEBAs) provide benefit payments to their members and their dependents. Supplemental unemployment benefit trusts (SUBs) provide payments to separated employees. The earnings on the monies invested in these organizations is exempt from gross income.

Purpose:

This provides an incentive to accumulate funds for the purposes of providing health care and other benefits, and providing income security during periods of unemployment.

Fiscal Impact:

FY 1996 . . . . $ 340,000
FY 1997 . . . . $ 340,000

24 PUBLIC ASSISTANCE BENEFITS

MCA 15-30-111

Description:

Public assistance benefits paid through Aid to Families with Dependent Children, General Assistance, Emergency Assistance, Supplemental Security Income, and other selected programs, are excluded from income.

Purpose:

Most of these types of benefits, provided on a means-tested basis, go to families and individuals of very low incomes. Taxing these benefits would be counter to the reason why they were provided in the first place.

Fiscal Impact:

FY 1996 . . . . $ 300,000
FY 1997 . . . . $ 340,000

25 RENTAL ALLOWANCES OF MINISTERS' HOMES

MCA 15-30-111

Description:

A minister may exclude a rental allowance or the rental value of a parsonage furnished by the church.

Purpose:

This exclusion provides financial assistance to individuals in the ministry.

Fiscal Impact:

FY 1996 . . . . $ 200,000
FY 1997 . . . . $ 200,000

26 LIKE-KIND EXCHANGES

MCA 15-30-111

Description:

No gain or loss is recognized in cases where property held for productive use in business is exchanged solely for property of a "like kind". The provision does not apply to inventory, stocks, bonds, notes, or other securities.

Purpose:

This provides for mobility and ease of administration in the transfer of certain assets.

Fiscal Impact:

FY 1996 . . . . $ 180,000
FY 1997 . . . . $ 200,000

27 PERMANENT EXEMPTION FROM IMPUTED INTEREST RULES

MCA 15-30-111

Description:

In certain cases, where installment sales or loan agreements fail to provide for interest at a minimum rate specified by law or the Internal Revenue Service, interest is imputed and included in gross income. Exemptions from the imputed interest rules include sales of less than $3,000, and lump-sum divorce payments/property settlements payable in installments.

Purpose:

This exclusion provides ease in the administration of tax laws.

Fiscal Impact:

FY 1996 . . . . $ 140,000
FY 1997 . . . . $ 140,000

28 DEFERRAL OF GAIN ON INSTALLMENT SALES BY NON-DEALERS

MCA 15-30-111

A method of accounting known as installment reporting may be used for installment sales of property by a non-dealer. Instead of reporting income in the year of the sale, the taxpayer is allowed to report income in the year when cash from the sale is received.

Purpose:

This exclusion grants financial assistance to non-dealers providing installment sales, by averting potential cash flow problems.

Fiscal Impact:

FY 1996 . . . . $ 140,000
FY 1997 . . . . $ 140,000

29 EMPLOYER-PROVIDED ACCIDENT AND DISABILITY INSURANCE

MCA 15-30-111

Description:

Premiums paid by an employer to an employee accident and disability plan are excluded from the gross income of the employee.

Purpose:

This provides an incentive for employers to provide compensation in the form of nontaxable insurance, rather than taxable wages and salaries; it also contributes to income security in the event of disabling accidents.

Fiscal Impact:

FY 1996 . . . . $ 140,000
FY 1997 . . . . $ 140,000

30 EDUCATION SAVINGS BONDS

MCA 15-30-111

Description:

Certain individuals who pay higher education expenses during a tax year may exclude from gross income, the amount received (both interest and principal) from the redemption of a qualified U.S. Savings Bond. A married individual must file a joint return to qualify for the exclusion.

Purpose:

This exclusion provides an incentive for individuals to invest in U.S. Savings Bonds, as a means to save for future higher education expenses.

Fiscal Impact:

FY 1996 . . . . $ 70,000
FY 1997 . . . . $ 110,000

31 INTEREST ON MONTANA STATE AND LOCAL GOVERNMENT DEBT

MCA 15-30-111

Description:

Interest received by individuals on Montana state and/or local government securities is not included in state adjusted gross income.

Purpose:

This provides a financial incentive for investment in Montana state and local government securities.

Fiscal Impact:

Data limitations pertaining to the split in the distribution of this income between in-state and out-of-state investors precludes an accurate estimate of the fiscal impact. The impact is probably more than $100,000, however.

32 OTHER EXCLUSIONS FROM FEDERAL INCOME

MCA 15-30-111

Description and Purpose:

There are a number of other exclusions from federal income whose tax expenditures each are less than $100,000. These are:

a) Agricultural Cost Sharing Payments

Conservation payments received under various programs of the U.S. Department of Agriculture are exempt from taxation. The payments must be used to conserve soil and water resources, improve forests, or provide a habitat for wildlife; they must not contribute to annual increases in income from the property; and must be for a capital expense. This is a subsidy and incentive for farmers to invest in conservation improvements.

b) Energy Conservation Subsidies Provided by Public Utilities

Energy conservation subsidies provided to taxpayers are excluded from income. This provides an incentive for investment in energy conservation.

c) Employee Awards

Employee achievement awards are deductible by the employee, only to the extent that the employer can deduct the cost of the award. Employer deductibility is limited to $400 for any individual, or $1,600 for a "qualified plan award". This exclusion provides an incentive to promote and foster productive performance and employee morale.

d) Retired Military Disability Pensions

Retired military personnel who have at least a 30% disability may exclude qualified pension payments. This provides financial support for disabled military retirees.

e) Employer-Provided Transportation Benefits

Cash reimbursements by an employer of up to $155 a month of qualified parking and up to $60 a month of the combined value of mass transit passes and transportation by a hired commuter vehicle are excluded from income (1994). These amounts are periodically adjusted for inflation. This exclusion provides a financial incentive to use mass transit.

f) Certain Foster Care Payments

Subject to certain conditions and limits, payments for foster care for services supplied in the provider's home are excluded from income. This provides an incentive and financial assistance in the caring of foster care individuals.

g) Employer-Provided Death Benefits

Benefits paid by an employer in the event of an employee's death, are excludable (up to $5,000) from the income of the beneficiaries or the employee's estate. This provides financial assistance to the beneficiaries of the employee.

h) Black Lung Disease Benefits to Disabled Coal Miners

Benefits are excluded from income, which are provided by certain federal programs to coal miners totally disabled as a result of black lung disease. Benefits granted to widows/dependents of coal miners who died as a result of black lung disease are also excluded.

Combined Fiscal Impact:

FY 1996 . . . . $ 300,000
FY 1997 . . . . $ 300,000

INDIVIDUAL INCOME TAX - DEDUCTIONS FROM FEDERAL INCOME

As with the previous section, the following deductions from federal income (items 33-42) are passive tax expenditures, in that they are derived from federal tax laws. The adoption of these deductions at the state level simplifies administration of the state tax code.

33 DEPRECIATION IN EXCESS OF STRAIGHT-LINE DEPRECIATION

MCA 15-30-111

Description:

Deductions for depreciation are allowed to reflect the wear, tear, and obsolescence of goods that have a useful life of more than one year purchased for use in businesses. Economic or straight-line depreciation is based on the expected economic life of an asset. Economic depreciation varies from asset to asset, and may be significantly different for personal property (equipment) relative to real property (structures).

Depreciation deductions may be increased in the early years of an asset's life in two ways: (1) alternative depreciation methods, such as double declining balance, may be applied, or (2) the economic life of the asset may be arbitrarily shortened, as was done with most assets under the Accelerated Cost Recovery System (ACRS).

Prior to 1981, depreciation was calculated using the Class Life Asset Depreciation Range System (ADR). Assets were assigned useful lives approximating their economic life, and taxpayers were allowed to use sum-of-the-year's-digits or the double declining balance methods, as well as the straight-line method of accounting. The Economic Recovery Tax Act of 1981 (ERTA) introduced the Accelerated Cost Recovery System (ACRS), which allowed the use of accelerated accounting methods applied over substantially shortened asset lives. ACRS is applicable to property placed in service after 1980 and before 1987.

The Tax Reform Act of 1986 (TRA86) revamped depreciation laws by introducing the Modified Accelerated Cost Recovery System (MACRS). MACRS extended the depreciable life of residential and nonresidential real estate, and required use of the straight-line method for these assets. With some exceptions, however, class lives for other property were kept the same as under ACRS, with some acceleration in accounting methods for specific classes of property allowed.

Depreciation that is in excess of straight-line depreciation schedules for an asset's estimated useful economic life, is considered a tax expenditure.

Purpose:

Accelerated methods of depreciation provide an incentive for investment in equipment and structures, by reducing the effective price of capital assets.

Fiscal Impact:

a) Rental Housing

FY 1996	$ 430,000
FY 1997	$ 400,000

b) Other Buildings

FY 1996	$ 900,000
FY 1997	$ 780,000

c) Equipment

FY 1996	$ 3,840,000
FY 1997	$ 3,800,000

d) TOTAL

FY 1996	$ 5,170,000
FY 1997	$ 4,980,000

34 CASH ACCOUNTING FOR AGRICULTURE

MCA 15-30-111

Description:

Farmers and ranchers may elect the cash method of accounting, rather than the accrual method. Generally, the accrual method is preferred as it matches income and expenses as of the date earned or incurred, rather than received/paid. The difference in taxes on net income between the cash and accrual methods is considered a tax expenditure. To the extent that expenses are pre-paid, the tax expenditure is related to a deduction from federal income; to the extent of income earned but not received, it represents an exclusion.

Purpose:

This provision provides financial assistance to farmers/ranchers electing the cash system of

accounting.

Fiscal Impact:

FY 1996	$ 680,000
FY 1997	$ 680,000

35 PARENTAL PERSONAL EXEMPTION FOR STUDENTS AGE 19 THROUGH 23

MCA 15-30-111

Description:

Taxpayers are allowed to claim an exemption for each dependent. Generally, persons with taxable gross income equal to or greater than the exemption amount don't qualify as dependents. One exception to this rule is that the gross income test does not apply if the dependent is the taxpayer's child and is a student, age 19 through 23.

Purpose:

This provides an incentive, and financial assistance, for education of taxpayers' children.

Fiscal Impact:

FY 1996	$ 610,000
FY 1997	$ 610,000

36 EXCESS OF PERCENTAGE DEPLETION OVER COST DEPLETION

MCA 15-30-111

Description:

All exhaustible natural deposits and timber qualify for deduction of a reasonable allowance for depletion based on the taxpayer's cost or other basis of the resources. This is referred to as "cost depletion", and is very similar to depreciation in its application. But in the case of minerals including certain oil and gas properties, the depletion deductions may be computed as a specified percentage of gross income (which has no relationship to the basis of the mineral), if greater than cost depletion. The amount of percentage depletion that is in excess of cost depletion is considered a tax expenditure.

Purpose:

This deduction provides a financial incentive to small operators for the extraction of oil, gas, and other mineral deposits.

Fiscal Impact:

FY 1996	$ 460,000
FY 1997	$ 640,000

37 EXPENSING CERTAIN AGRICULTURAL MULTI-PERIOD PRODUCTION COSTS

MCA 15-30-111

Description:

Farmers and ranchers may elect to deduct, rather than capitalize, fertilizer costs, costs of raising livestock, and soil and water conservation expenditures, even if the benefits from these purchases last more than one year.

Purpose:

This provides economic assistance to the farming and ranching community.

Fiscal Impact:

FY 1996	$ 550,000
FY 1997	$ 550,000

38 EXPENSING DEPRECIABLE BUSINESS PROPERTY

MCA 15-30-111

Description:

Certain taxpayers may elect to expense up to $17,500 per year of the value of depreciable property used in the active conduct of a trade or business. The $17,500 expense election is reduced dollar-for-dollar for eligible personal property placed in service in excess of $200,000.

Purpose:

This expensing option results in an incentive for investment in equipment, especially for small businesses.

Fiscal Impact:

FY 1996 . . . . $ 310,000
FY 1997 . . . . $ 220,000

39 EXPENSING MULTI-PERIOD TIMBER GROWING COSTS

MCA 15-30-111

Description:

Multi-period costs incurred for management and protection (labor and materials for fire, disease and insect control, and expenses for the removal of unwanted trees and brush) of timber stands within the first one to two years after planting are deductible.

Purpose:

This provision provides financial assistance in the development of new stands of timber.

Fiscal Impact:

FY 1996 . . . . $ 190,000
FY 1997 . . . . $ 190,000

40 AMORTIZATION OF BUSINESS START-UP COSTS

MCA 15-30-111

Description:

Taxpayers may elect to amortize (expense) qualifying business start-up costs over at least a five-year period. Start-up costs include expenditures connected with investigating the creation or acquisition of an active trade or business, and certain other costs of creating an active trade or business. In the absence of this provision, these costs would be included in the original basis of the business and not recovered until the business was sold.

Purpose:

This provides an incentive for the formation of new businesses, and mitigates the tax impact on new businesses.

Fiscal Impact:

FY 1996 . . . . $ 140,000
FY 1997 . . . . $ 140,000

41 EXPENSING OF EXPLORATION AND DEVELOPMENT COSTS

MCA 15-30-111

Description:

"Intangible" drilling and development costs of oil, gas, and geothermal wells, and expenditures for the development of minerals other than oil or gas, may be fully deducted in the year in which they occur.

Purpose:

This provides a financial incentive for the exploration and development of natural resources.

Fiscal Impact:

FY 1996 . . . . $ 90,000
FY 1997 . . . . $ 90,000

42 OTHER DEDUCTIONS FROM FEDERAL INCOME

MCA 15-30-111

Description and Purpose:

There are a number of other exclusions from federal income whose tax expenditures each are less than $100,000. These are:

a) Expensing Research and Development Expenditures

Taxpayers may choose to immediately deduct rather than to capitalize research and development expenditures made in connection with a trade or business. This is an incentive for starting businesses, by providing financial assistance in the first year of qualifying expenditures.

b) Special Rules for Mining Reclamation Reserves

Normally, accounting rules will not allow a deduction for expenses associated with

reclamation activities until the activities are actually performed. However, taxpayers may make a special election to deduct current allocations to a reserve fund dedicated to reclamation activities. The amount allocable in each year is limited to the amount needed to raise the reserve to a level sufficient to reclaim, at current prices, the amount of land thus far disturbed. This provides an incentive to insure funding for reclamation activities will be available at the time reclamation is to be performed.

c) Cash Accounting for Non-Agricultural Sectors

Taxpayers may elect the cash method of accounting, rather than the accrual method. Generally, the accrual method is preferred as it matches income and expenses as of the date earned/incurred, rather than received or paid. The difference in taxes on net income between the cash and accrual methods is considered a tax expenditure. This provision of federal tax law provides financial assistance to businesses electing the cash method of accounting.

d) Expensing Costs of Removing Architectural and Transportation Barriers

A taxpayer may elect to treat up to $15,000 of qualified architectural and transportation barrier removal expenses as a current deduction, rather than as a charge to a capital account. This provides financial assistance to help make businesses more accessible to physically challenged persons.

e) Expensing Magazine Circulation Expenditures

Generally, expenses incurred in creating or developing an asset must be capitalized (i.e., included in the value of the asset). However, under this provision of federal law, publishers of periodicals can deduct expenditures to establish, maintain, and increase circulation. This provides financial assistance to publishers of periodicals.

f) Deduction for Clean-Fuel Vehicles and Refueling Property

A portion of the cost of qualifying clean-fuel vehicles and related refueling facilities is deductible for property placed in service before 2005. This tax provision is an incentive for the introduction of more clean-fuel vehicles and a subsequent improve in air quality.

Combined Fiscal Impact:

FY 1996 . . . . $ 90,000
FY 1997 . . . . $ 90,000

INDIVIDUAL INCOME TAX - MONTANA EXCLUSIONS/EXEMPTIONS

The following exclusions and exemptions (items 43-49) are above and beyond federal exclusions/exemptions. They are specific to Montana and were enacted by various state legislatures.

43 EXEMPT RETIREMENT INCOME

MCA 15-30-111 (2)

Description:

Taxpayers are allowed to exclude up to $3,600 in pension and annuity income. For filers with federal adjusted gross income greater than $30,000, the $3,600 exclusion is reduced by $2 for every $1 of federal adjusted gross income in excess of $30,000. The exclusion is zero for taxpayers with federal adjusted gross income over $31,800.

Purpose:

This provides economic relief to retirees.

Fiscal Impact:

FY 1996	$ 5,870,000
FY 1997	$ 6,170,000

44 ADDITIONAL EXEMPTIONS FOR THE 65 AND OVER AGE GROUP, AND FOR CERTAIN PHYSICALLY CHALLENGED PERSONS

MCA 15-30-112 and 15-30-114

Description:

Taxpayers and their spouses are both allowed additional exemptions if 65 years of age and over. Certain visually impaired taxpayers and their spouses are also granted additional exemptions. In addition, certain disabled dependent children are eligible for an extra exemption. In tax year 1991 there were 83,596 additional exemptions claimed under this provision.

Purpose:

This provides financial assistance to the age 65 and over and physically challenged groups.

Fiscal Impact:

FY 1996	$ 4,620,000
FY 1997	$ 4,910,000

45 EXEMPT UNEMPLOYMENT BENEFITS

MCA 15-30-101 (7)

Description:

Unemployment compensation is excluded from gross income.

Purpose:

The purpose of this exclusion is to provide additional economic assistance to unemployed persons.

Fiscal Impact:

FY 1996	$ 2,580,000
FY 1997	$ 2,540,000

46 INTEREST EXCLUSION FOR 65 AND OVER AGE GROUP

MCA 15-30-111 (2)

Description:

Taxpayers age 65 or older are allowed an exclusion of interest income up to $800 if filing a single, married-separate, or head-of-household return; and up to $1,600 if filing a joint return.

Purpose:

This tax provision gives economic relief to taxpayers, age 65 and over.

Fiscal Impact:

FY 1996	$ 1,950,000
FY 1997	$ 2,040,000

47 CAPITAL GAINS EXCLUSION

MCA 15-30-110

Description:

Taxpayers are allowed to exclude from adjusted gross income 40 percent of the gain from the sale or exchange of capital assets, stemming from agreements entered into before January 1, 1987.

Purpose:

The Tax Reform Act of 1986 eliminated the 60 percent exclusion for long-term capital gains, and required 100 percent of capital gains to be reported as ordinary income. The 40 percent Montana exclusion provides an inflationary hedge for Montana investors who entered into installment sales agreements prior to January 1, 1987. Over time this tax expenditure will erode to zero.

Fiscal Impact:

FY 1996 . . . . $ 720,000
FY 1997 . . . . $ 530,000

48 EXCLUDED TIP INCOME

MCA 15-30-111

Description:

Income from tips received for services provided in licensed food, beverage, or lodging businesses are excludable.

Purpose:

This exclusion gives financial relief to food, beverage, and lodging service workers, as well as provides ease of tax administration.

Fiscal Impact:

FY 1996 . . . . $ 550,000
FY 1997 . . . . $ 590,000

49 OTHER MONTANA EXCLUSIONS

MCA 15-30-111 and 80-12-211

Description and Purpose:

Montana and federal statutes provide for the following exclusions from income:

a) Disability Income

Disability payments of up to $5,200 per year are excludable. This provides financial assistance to persons receiving disability income.

b) Wages Covered by Federal Targeted Jobs Credit

Employers may deduct the full amount of wages and salaries for employees hired under the federal targeted jobs program, even though the employer claims a tax credit for this activity. Under federal law, the wage and salary deduction must be reduced dollar for dollar for the amount of the credit.

c) Land Sales to Beginning Farmers

Up to $50,000 in income or capital gains from the sale of land consisting of more than 80 acres to a beginning farmer at 9% or less interest on a long-term contract is excludable. This provides financial assistance to farmers/ranchers, and is an incentive for land to remain in an agricultural use.

d) Indian Reservation Income

Income earned by an enrolled member of an American Indian tribe while living and working on a reservation is excludable. This gives financial relief to tribal members, living and working on a reservation.

e) Independent Liability Funds

Amounts contributed by small businesses to independent liability funds may be deducted. This provision encourages the use of independent liability funds by small businesses defined by criteria of the U.S. Small Business Administration.

f) S Corporation Income

Undistributed earnings from federal S Corporations for which a comparable election has not been made for state tax purposes is excludable. The purpose of this provision is to reconcile the divergent tax treatment afforded the same corporation at different levels of government.

g) **Exempt Military Pay**

Active duty pay for a member of the regular armed forces is exempt. This exemption grants financial relief to members of the armed forces on active duty.

Combined Fiscal Impact:

Because these items are all reported on a single line on the tax form, it is not possible to accurately disaggregate the individual impact of each one. Therefore, the total expenditure of all of the above items taken together is reported.

FY 1996 . . . . $ 17,700,000
FY 1997 . . . . $ 19,180,000

INDIVIDUAL INCOME TAX - ITEMIZED DEDUCTIONS

Montana's itemized deductions are primarily passive in nature in that most are tied to allowable federal itemized deductions. However, itemized deductions for federal income taxes paid during the tax year, child and dependent care expenses, and long-term care insurance premiums are Montana-specific deductions.

50 FEDERAL INCOME TAX PAID

MCA 15-30-121 (2)

Description:

A deduction is allowed for the amount of federal income tax actually paid during the tax year.

Purpose:

Provides financial assistance to those taxpayers using this deduction.

Fiscal Impact:

FY 1996 . . . . $ 108,120,000
FY 1997 . . . . $ 115,210,000

51 HOME MORTGAGE INTEREST

MCA 15-30-121 (1)

Description:

Qualified residence interest is deductible to the extent that it represents interest on "acquisition indebtedness" not in excess of $1,000,000; or "equity indebtedness" not in excess of $100,000. "Acquisition indebtedness" is debt incurred in acquiring, constructing, or improving the residence; "equity indebtedness" is any indebtedness, other than acquisition indebtedness, to the extent that total indebtedness does not exceed the fair market value of the residence. Qualified residence is the taxpayer's principle residence and/or a second residence selected by the taxpayer, for the tax year.

Purpose:

The deduction for home mortgage interest reduces the cost of homeownership, provides an incentive for residential development and economic growth, and promotes the social goal of affordable housing.

Fiscal Impact:

FY 1996 . . . . $ 31,940,000
FY 1997 . . . . $ 33,110,000

52 CONTRIBUTIONS

MCA 15-30-121 (1)

Description:

Contributions to organizations that are religious, charitable, educational, scientific, or literary in purpose are deductible. Generally, the deduction for contributions is limited to 50% of an individual's adjusted gross income.

Purpose:

This deduction acts to reduce the cost of making charitable contributions, thereby increasing the amount of these types of contributions.

Fiscal Impact:

FY 1996 . . . . $ 16,820,000
FY 1997 . . . . $ 17,800,000

53 REAL AND PERSONAL PROPERTY TAXES

MCA 15-30-121 (1)

Description:

A deduction is allowed for any taxes paid on real and personal property not associated with the taxpayer's business.

Purpose:

Allowing a deduction for property taxes enhances the ability of local governments to raise revenues needed to fund local activities.

Fiscal Impact:

FY 1996 . . . . $ 14,590,000
FY 1997 . . . . $ 15,490,000

54 MEDICAL AND DENTAL EXPENSE

MCA 15-30-121 (1)

Description:

Expenditures for specified medical expenses are deductible to the extent that they exceed 7.5% of the taxpayer's adjusted gross income.

Purpose:

The deduction for medical expenses is provided on the grounds that these types of expenditure are largely involuntary, and may be burdensome to the point of substantially reducing tax capacity. The deduction also provides limited financial relief to those individuals having no health insurance coverage.

Fiscal Impact:

FY 1996 . . . . $ 9,950,000
FY 1997 . . . . $ 10,610,000

55 MISCELLANEOUS DEDUCTIONS

MCA 15-30-121 (1)

Description:

The Tax Reform Act of 1986 provided for two types of miscellaneous deductions. The first type, which includes unreimbursed job related expenses and expenses associated with producing other income, is subject to a 2% of adjusted gross income floor.

Other miscellaneous expenses, such as gambling losses, are not subject to the floor.

Purpose:

This deduction is allowed on the general understanding that costs associated with the production of income are appropriately deductible.

Fiscal Impact:

FY 1996 . . . . $ 7,010,000
FY 1997 . . . . $ 7,220,000

56 DEDUCTIBLE INVESTMENT INTEREST

MCA 15-30-121 (1)

Description:

The deduction for investment interest was limited by the Tax Reform Act of 1986. Investment interest is deductible only to the extent of "net investment income"; however, interest that is disallowed due to this limitation may be carried over to subsequent years.

Purpose:

Technically, the deduction for interest on investments represents an allowance for costs associated with acquiring specific assets. Failing to allow the deduction would result in an overstatement of *net* income. Practically speaking, the deduction provides an incentive for savings and investment.

Fiscal Impact:

FY 1996 . . . . $ 2,240,000
FY 1997 . . . . $ 2,180,000

57 OTHER DEDUCTIBLE TAXES

MCA 15-30-121 (1)

Description:

A deduction is allowed for motor vehicle fees and taxes, and any other deductible taxes paid during the tax year.

Purpose:

Allowing a deduction for motor vehicles is consistent with allowing a deduction for other forms of personal property.

Fiscal Impact:

FY 1996	$ 2,280,000
FY 1997	$ 2,400,000

58 LONG-TERM CARE INSURANCE PREMIUMS

MCA 15-30-121 (1)

Description:

Insurance premiums paid to provide for long-term care insurance are deductible in full. In order to qualify for the deduction, the benefits provided by the insurance policy must meet or exceed the minimum standards established by the Montana State Auditor's Office, Insurance Commission Division.

Purpose:

Provides an incentive for taxpayers to purchase an alternative means of providing long-term care (e.g., nursing home care). Provision of long-term care through private insurance reduces the reliance on public (Medicaid) payments for these types of services, thereby reducing state obligations and expenditures.

Fiscal Impact:

FY 1996	$ 280,000
FY 1997	$ 280,000

59 CASUALTY/THEFT LOSSES

MCA 15-30-121 (1)

Description:

A taxpayer may deduct casualty and theft losses on personal property only to the extent that 1) the loss exceeds $100, and 2) all of the casualty or theft losses for the year exceed 10% of adjusted gross income for the year. With regard to theft losses, the loss amount is equal to the lesser of the property's fair market value or adjusted basis, reduced by any insurance or other compensation received or recoverable.

Purpose:

Casualty and theft losses are viewed as "negative" income in the year of loss, and are hence, allowed as a deduction. The validity of this deduction is sometimes called into question on the grounds that almost all such losses are covered by insurance.

Fiscal Impact:

FY 1996 . . . . $ 130,000
FY 1997 . . . . $ 120,000

60 CHILD/DEPENDENT CARE EXPENSE

MCA 15-30-121 (3)

Description:

This deduction is not provided at the federal level, but is provided specifically through state statutes. Subject to specific rules and limitations, taxpayers are allowed a deduction for employment-related expenses associated with child and/or dependent care.

Purpose:

This deduction is intended to provide economic relief to households where the expense of caring for dependents, necessary to allow gainful employment, is detrimentally burdensome.

Fiscal Impact:

FY 1996 . . . . $ 30,000
FY 1997 . . . . $ 30,000

INDIVIDUAL INCOME TAX - MONTANA CREDITS

The following state tax credits (items 61-71) are all tax expenditure items at the state level.

61 INCOME TAXES PAID TO OTHER STATES OR COUNTRIES

MCA 15-30-124

Description:

Residents whose Montana adjusted gross income includes income from a state or country which does not allow a credit for Montana income tax are allowed a credit for income tax paid the other state or country.

Purpose:

This prevents the double taxation of income.

Fiscal Impact:

FY 1996 . . . . $ 7,700,000
FY 1997 . . . . $ 8,500,000

62 ELDERLY HOMEOWNER/RENTER CREDIT

MCA 15-30-171 through 15-30-179

Description:

Residents age 62 or older who have lived in Montana for at least 9 months during the claim period, are eligible for a refundable property tax credit not to exceed $400. This credit is claimed on the individual income tax form.

Purpose:

This provides financial assistance to homeowners/renters, age 62 and over, on fixed incomes.

Fiscal Impact:

FY 1996 . . . . $ 6,000,000
FY 1997 . . . . $ 6,500,000

63 RURAL PHYSICIAN TAX CREDIT

MCA 15-30-188 through 15-30-191

Physicians who commence practice in a rural area (a place without a hospital of at least 60 beds within a radius of 30 miles) are granted a nonrefundable credit of $5,000, which may be claimed in four successive years. To qualify for the credit, the physician must maintain a practice for at least 9 months of the taxable year in which the credit is claimed.

Purpose:

The purpose of this credit is to encourage the location and relocation of physicians in medically-underserved rural areas.

Fiscal Impact:

FY 1996 . . . . $ 350,000
FY 1997 . . . . $ 350,000

64 CONTRACTORS' GROSS RECEIPTS CREDIT

MCA 15-50-207

Description:

Contractors are required to pay an additional license fee equal to 1% of the gross receipts from government contracts during the income year for which the license is issued. This additional fee is allowed as a credit against the contractor's individual income tax liability.

Purpose:

This provision of tax law facilitates the taxation of prime and sub-contractors, while protecting the primary contractor from being taxed twice on the same earnings.

Fiscal Impact:

FY 1996 . . . . $ 280,000
FY 1997 . . . . $ 250,000

65 INSTALLATION OF NON-FOSSIL ENERGY SYSTEMS

MCA 15-32-115 and 15-32-201

Description:

Resident taxpayers who install an energy system using a non-fossil form of energy generation (including geothermal systems and wood stoves) in their principal dwelling, are entitled to a credit of up to $250 ($500 for pellet stoves). With the exception of geothermal installations, an excess tax credit may be carried forward for four years.

Purpose:

This credit provides an economic incentive for the installation of non-fossil energy systems, and promotes conservation of fossil fuels.

Fiscal Impact:

FY 1996 . . . . $ 250,000
FY 1997 . . . . $ 200,000

66 INVESTMENT TAX CREDIT

MCA 15-30-162

Description:

Montana allows an investment credit equal to 5% of the federal investment credit up to a maximum of $500 in any given taxable year. The federal Tax Reform Act of 1986 repealed the federal investment credit. Consequently, the tax expenditures associated with this credit in future years will reflect only the carryforward amounts allowed under current law.

Purpose:

Investment credit provisions are designed to stimulate investment and economic growth.

Fiscal Impact:

FY 1996 . . . . $ 220,000
FY 1997 . . . . $ 210,000

67 RECYCLING CREDIT

MCA 15-32-601 through 15-32-611

Description:

Qualifying taxpayers may claim a credit of 25% of the cost of qualifying property used to collect or process "reclaimable material", or to manufacture a product from reclaimed material, in the year in which the property is purchased.

Purpose:

The purpose of this credit is to provide an incentive to accumulate and process reclaimable materials, reduce the burden on local landfills, and to enhance the quality of the environment.

Fiscal Impact:

FY 1996 . . . . $ 200,000
FY 1997 . . . . $ 200,000

68 INVESTMENT IN ENERGY CONSERVATION INSTALLATIONS

MCA 15-32-109

Description:

A resident taxpayer who makes a capital investment in a building for an energy conservation purpose, is allowed a nonrefundable credit equal to 5% of the expenditure up to $150 for a residential building, and 5% of the expenditure up to $300 for a building not used as a residence.

Purpose:

This provides an economic incentive for energy conservation expenditures, and promotes conservation of fossil fuels.

Fiscal Impact:

FY 1996 . . . . $ 150,000
FY 1997 . . . . $ 150,000

69 MONTANA CAPITAL COMPANY CREDIT

MCA 90-8-202

Description:

Taxpayers are allowed an income tax credit for investing in certified Montana capital companies. The credit is limited to 50% of the investment up to $150,000 per taxpayer for regular capital companies, and up to an additional $250,000 for the one qualified Montana small business investment capital company.

Purpose:

This provides an incentive to encourage the formation of venture and equity capital in Montana.

Fiscal Impact:

FY 1996 . . . . $ 130,000
FY 1997 . . . . $ 150,000

70 COLLEGE CONTRIBUTION CREDIT

MCA 15-30-163

Description:

Taxpayers may claim as a credit against their income tax 10 percent of the amount of their contributions to the general endowment funds of the Montana University System foundations, or to the general endowment fund of a Montana private college or its foundation.

Purpose:

This credit encourages contributions to Montana colleges and universities.

Fiscal Impact:

FY 1996 . . . . $ 100,000
FY 1997 . . . . $ 105,000

71 OTHER MONTANA CREDITS

Description and Purpose:

a) Elderly Care Credit (MCA 15-30-128)

This credit is available to individuals for a portion of qualifying health expenses incurred in taking care of a family member 65 years of age and over, determined disabled by the Social Security Administration, and with gross income of not more than $15,000 (unmarried members), $30,000 (married members). The credit is limited to $5,000 per qualifying family member up to a maximum of two members, and generally is not available for taxpayers with adjusted gross income greater than $55,000. This credit provides financial assistance to those individuals incurring a financial burden due to caring for a disabled family member aged 65 and over, and reduces state general fund Medicaid expenditures for nursing home care.

b) Dependent Care Assistance Credit (MCA 15-30-186)

Employers are granted a credit for dependent care assistance actually provided to employees, if the assistance is furnished by a registered or licensed day-care provider. The amount of the credit is 20 percent of expenditures up to a maximum credit of $1,250. This provides an incentive for employers to fund dependent care assistance programs, and thus grants financial relief to working parents.

c) Employer Disability Insurance Credit (MCA 15-30-129 and 15-31-132)

Employers with 20 or fewer employees, may claim a nonrefundable credit of up to $3,000 for expenditures on employee health insurance premiums. The credit may not exceed 50 percent of the premium cost for each employee, and may not be claimed for a period of more than three years. The purpose of this credit is to encourage health insurance coverage for uninsured employees.

d) Wind-Powered Generation Equipment Credit (MCA 15-32-401 through 407)

Taxpayers are allowed a credit of 35% of the eligible costs for investments of $5,000 or more in commercial wind-generation systems. Eligible costs include certain expenditures for generating equipment, safety devices, or transmission lines. If the investment receives federal wind-generation credits, the state credit must be reduced by the amount of federal credit such that the effective credit does not exceed 60% of the eligible costs. The credit may be carried forward for a period of seven years. This credit encourages the development of a wind energy industry in Montana.

e) Alternative Fuels Tax Credit (MCA 15-30-164)

Qualifying taxpayers may receive a nonrefundable tax credit of up to 50% of the

equipment and labor costs incurred to convert a motor vehicle to operate on alternative fuel (natural gas, liquefied natural gas, electricity, etc.). The credit may not exceed $500 for converting vehicles with gross vehicle weight of 10,000 pounds or less; $1,000 for vehicles weighing over 10,000 pounds. The credit is allowed only in the year of conversion. The purpose of this credit is to stimulate the use of alternative fuels, thereby providing an incentive for the conservation of petroleum.

Combined Fiscal Impact: The projected combined fiscal impact of the above discussed credits, and "all other credits" reported on individual income tax returns for the 1997 biennium is as follows:

FY 1996	$ 450,000
FY 1997	$ 525,000

CORPORATION LICENSE TAX

OVERVIEW AND SUMMARY

Montana ties its corporation license tax directly to the federal definition of corporate taxable income. Corporations are then required to add back to federal taxable income any Montana corporation tax deducted for federal purposes, additions to reserves for bad debts, and other miscellaneous additions. They are allowed to deduct bad debts actually charged off, Montana net operating losses, and other miscellaneous deductions.

The corporation license tax base may be summarized as follows:

	Federal Taxable Income
Plus:	Montana Corporation License Tax Additions to Reserves for Bad Debts Other Additions
Less:	Bad Debts Charged Off Other Deductions Montana Net Operating Losses
Equals:	**Montana Taxable Income**

Tax liability is computed as 6.75 percent of Montana taxable income, but in any case not less than $50. (For corporations making a "water's edge" election the tax rate is 7 percent.)

Because Montana ties so closely to federal taxable income, almost all of the tax expenditures associated with the corporation license tax are "passive" in nature. However, there are a number of federal corporation tax expenditures that are not applicable to Montana. For example, several federal tax expenditure items are directed at insurance companies (underwriters). Because insurance companies pay a premiums tax in Montana, they are exempt from the corporation license tax, and hence, have no corporation license tax expenditure items. Entities that are exempt from one form of tax in lieu of paying another form of tax are not considered in tax expenditure analysis.

In addition to the above mentioned federal tax expenditure items, Montana provides for several state-specific tax credits. These are discussed below after the summary tax expenditure table and the more detailed discussion of passive expenditures.

SUMMARY OF CORPORATION LICENSE TAX EXPENDITURES

Exclusions from Federal Income (pages 58-60)

	Tax Expenditure Item	Fiscal Impact (thousands $) FY 1996	FY 1997	Biennium
1.	Exclusion of Investment Income on Life Insurance and Annuity Contracts	320	360	680
2.	Exclusion of Income of Foreign Sales Corporations	290	300	590
3.	Other Exclusions from Federal Income	370	400	770

Deductions from Federal Income (pages 60-68)

	Tax Expenditure Item	FY 1996	FY 1997	Biennium
4.	Depreciation in Excess of Straight-line Depreciation	9,520	9,340	18,860
5.	Expensing Multi-period Timber Growing Costs	2,380	2,520	4,900
6.	Inventory Property Sales Source	710	730	1,440
7.	Cash Accounting for Agriculture	590	590	1,180
8.	Deductibility of Charitable Contributions	470	470	940
9.	Excess of Percentage Depletion Over Cost Depletion	450	450	900
10.	Employee Stock Ownership Plans	360	400	760
11.	Expensing of Exploration and Development Costs	320	320	640
12.	Expensing Depreciable Business Property	330	250	580
13.	Completed Contract Rules	190	190	380

	Tax Expenditure Item	Fiscal Impact (thousands $) FY 1996	FY 1997	Biennium
14.	Expensing of Research and Development Expenditures	180	90	270
15.	Other Deductions from Federal Income	200	200	400

<u>Montana Credits</u> (pages 68-71)

16.	Contractors' Gross Receipts	1,070	1,010	2,080
17.	Investment Tax Credit	220	220	440
18.	Recycling Credit	180	200	380
19.	Montana Capital Company Credit	190	190	380
20.	Other Credits	70	70	140

CORPORATION LICENSE TAX - EXCLUSIONS FROM FEDERAL INCOME

The following exclusions from federal income (items 1-3), are all passive tax expenditures associated with the federal tax code, and are incorporated into the Montana tax code to simplify administration.

1 EXCLUSION OF INVESTMENT INCOME ON LIFE INSURANCE AND ANNUITY CONTRACTS

MCA 15-31-113

Description:

Frequently, corporations purchase life insurance policies on certain employees. As with individuals, the "dividends" earned on the accumulated premiums are excluded from income.

Purpose:

This provision encourages investment in instruments deemed to be of social value.

Fiscal Impact:

FY 1996 . . . . $ 320,000
FY 1997 . . . . $ 360,000

2 EXCLUSION OF INCOME OF FOREIGN SALES CORPORATIONS

MCA 15-31-113

Description:

Depending on the pricing rule in effect, a portion of the foreign trade income of a Foreign Sales Corporation is exempt from tax. If the income is based on "arms-length" pricing, 32% of foreign trade income is exempt. If income is determined under special administrative pricing rules, the exempt portion is 16/23 of the foreign trade income from the transaction.

Purpose:

This provides financial assistance to corporations through the form of export subsidies.

Fiscal Impact:

FY 1996 . . . . $ 290,000
FY 1997 . . . . $ 300,000

3 OTHER EXCLUSIONS FROM FEDERAL INCOME

MCA 15-31-113

Description and Purpose:

There are four additional tax expenditures as a result of exclusions from federal income. All expenditures are estimated to be less than $100,000 per year. These additional tax expenditure items are as follows:

a) Like-kind Exchanges

No gain or loss is recognized in cases where property held for productive use in business is exchanged solely for property of a "like kind". The provision does not apply to inventory, stocks, bonds, notes, or other securities. This provides for mobility and ease of administration in the transfer of certain assets.

b) Gain from a Sale or Exchange to Comply with FCC Policies

Under certain conditions, a corporation which is ordered to sell or exchange its holding to comply with a change in policy (or the creation of a new policy) by the Federal Communications Commission, can choose to treat the situation as an involuntary conversion of property. Under such circumstances any gain identified will not be recognized. The purpose of this tax code provision is to promote compliance with new or changing policies of the Federal Communications Commission.

c) Deferral of Gain on Non-Dealer Installment Sales

A method of accounting known as installment reporting may be used for installment sales of property by a non-dealer. Instead of reporting income in the year of the sale, the taxpayer is allowed to report income in the year when cash from the sale is received. This exclusion grants financial assistance to non-dealers providing installment sales, by averting potential cash flow problems.

d) Permanent Exemption from Imputed Interest Rules

In certain cases, where installment sales or loan agreements fail to provide for interest at a minimum rate specified by law or the Internal Revenue Service, interest is imputed and included in gross income. Sales of less than $3,000 are exempted from the imputed

interest rules. This provides for ease in the administration of tax laws.

Combined Fiscal Impact:

FY 1996	$ 370,000
FY 1997	$ 400,000

CORPORATION TAX - DEDUCTIONS FROM FEDERAL INCOME

The following tax expenditures (items 4-15) are passive in nature and are incorporated into state tax laws to simplify administration.

4 DEPRECIATION IN EXCESS OF STRAIGHT-LINE DEPRECIATION

MCA 15-31-113

Description:

Deductions for depreciation are allowed to reflect the wear, tear, and obsolescence of goods purchased for use in businesses that have a useful life of more than one year. Economic or straight-line depreciation is based on the expected economic life of an asset. Economic depreciation varies from asset to asset, and may be significantly different for personal property (equipment) relative to real property (structures).

Depreciation deductions may be increased in the early years of an asset's life in two ways: (1) alternative depreciation methods, such as double declining balance, may be applied, or (2) the economic life of the asset may be arbitrarily shortened, as was done with most assets under the Accelerated Cost Recovery System (ACRS).

Prior to 1981, depreciation was calculated using the Class Life Asset Depreciation Range System (ADR). Assets were assigned useful lives approximating their economic life, and taxpayers were allowed to use sum-of-the-year's-digits or the double declining balance methods, as well as the straight-line method of accounting. The Economic Recovery Tax Act of 1981 (ERTA) introduced the Accelerated Cost Recovery System (ACRS), which allowed the use of accelerated accounting methods applied over substantially shortened asset lives. ACRS is applicable to property placed in service after 1980 and before 1987.

The Tax Reform Act of 1986 (TRA86) revamped depreciation laws by introducing the Modified Accelerated Cost Recovery System (MACRS). MACRS extended the depreciable life of residential and nonresidential real estate, and required use of the straight-line method for these assets. With some exceptions, however, class lives for other property were kept

the same as under ACRS, with some acceleration in accounting methods for specific classes of property allowed.

Depreciation that is in excess of straight-line depreciation schedules for an asset's estimated useful economic life, is considered a tax expenditure.

Purpose:

Accelerated methods of depreciation provide an incentive for investment in equipment and structures, by reducing the effective price of capital assets.

Fiscal Impact:

a) Rental Housing

FY 1996	$ 390,000
FY 1997	$ 380,000

b) Other Buildings

FY 1996	$ 1,340,000
FY 1997	$ 1,200,000

c) Equipment

FY 1996	$ 7,790,000
FY 1997	$ 7,760,000

d) TOTAL

FY 1996	$ 9,520,000
FY 1997	$ 9,340,000

5 EXPENSING MULTI-PERIOD TIMBER GROWING COSTS

MCA 15-31-113

Description:

Multi-period costs incurred for management and protection (labor and materials for fire, disease and insect control, and expenses for the removal of unwanted trees and brush) of timber stands within the first one to two years after planting are deductible.

Purpose:

This provision provides financial assistance in the development of new stands of timber.

Fiscal Impact:

FY 1996 . . . . $ 2,380,000
FY 1997 . . . . $ 2,520,000

6 INVENTORY PROPERTY SALES SOURCE RULE EXCEPTION

MCA 15-31-113

Description:

The general rule for the sourcing of income from the sale of personal property as either U.S. source income or foreign source income, is based on the residency of the seller. However, an exception is provided for the sale of inventory property. Under this exception, income is sourced to the location where the inventory was sold.

Purpose:

This provides financial assistance to firms with large inventories stored in foreign locations.

Fiscal Impact:

FY 1996 . . . . $ 710,000
FY 1997 . . . . $ 730,000

7 CASH ACCOUNTING FOR AGRICULTURE

MCA 15-31-113

Description:

Farmers and ranchers may elect the cash method of accounting, rather than the accrual method. Generally, the accrual method is preferred as it matches income and expenses as of the date earned or incurred, rather than received/paid. The difference in taxes on net income between the cash and accrual methods is considered a tax expenditure. To the extent that expenses are pre-paid, the tax expenditure is related to a deduction from federal income; to the extent of income earned but not received, it represents an exclusion.

Purpose:

This provision represents financial assistance to farmers/ranchers electing the cash system of accounting.

Fiscal Impact:

FY 1996	$ 590,000
FY 1997	$ 590,000

8 DEDUCTIBILITY OF CHARITABLE CONTRIBUTIONS

MCA 15-31-113

Description:

Contributions to organizations that are religious, charitable, educational, scientific, or literary in purpose are deductible.

Purpose:

This deduction acts to reduce the cost of making charitable contributions, thereby increasing the amount of these contributions.

Fiscal Impact:

FY 1996	$ 470,000
FY 1997	$ 470,000

9 EXCESS OF PERCENTAGE DEPLETION OVER COST DEPLETION

MCA 15-31-113

Description:

All exhaustible natural deposits and timber qualify for deduction of a reasonable allowance for depletion based on the taxpayer's cost or other basis of the resources. This is referred to as "cost depletion", and is very similar to depreciation in its application. But in the case of minerals, including certain oil and gas properties, the depletion deductions may be computed as a specified percentage of gross income (which has no relationship to the basis of the mineral), if greater than cost depletion. The amount of percentage depletion that is in excess of cost depletion is considered a tax expenditure.

Purpose:

This deduction provides a financial incentive for the extraction of oil, gas, and other mineral deposits.

Fiscal Impact:

FY 1996 . . . . $ 450,000
FY 1997 . . . . $ 450,000

10 EMPLOYEE STOCK OWNERSHIP PLANS

MCA 15-31-113

Description:

An Employee Stock Ownership Plan (ESOP) is either a stock bonus benefit plan, or a combination stock bonus and fixed percentage defined contribution pension plan, which invests primarily in the securities of the given employer. For contributions to an ESOP made in 1983 through 1986, corporate taxpayers were allowed to deduct the lesser of either the total value of employer securities transferred to the ESOP each year, or 0.5 percent of the annual compensation of all employees covered by the plan. At the federal level this provision was a tax credit, while at the state level it was a deduction. The employer contributions to an ESOP deduction is still a relevant tax expenditure because of the 15 year carryover provision for this item.

Purpose:

This provides an incentive for the development and expansion of Employee Stock Ownership Plans.

Fiscal Impact:

FY 1996 . . . . $ 360,000
FY 1997 . . . . $ 400,000

11 EXPENSING OF EXPLORATION AND DEVELOPMENT COSTS

MCA 15-31-113

Description:

"Intangible" drilling and development costs of oil, gas, and geothermal wells, and

expenditures for the development of minerals other than oil or gas, may be fully deducted in the year in which they occur.

Purpose:

This provides a financial incentive for the exploration and development of natural resources.

Fiscal Impact:

FY 1996 . . . . $ 320,000
FY 1997 . . . . $ 320,000

12 EXPENSING DEPRECIABLE BUSINESS PROPERTY

MCA 15-31-113

Description:

Certain taxpayers may elect to expense up to $17,500 per year of the value of depreciable property used in the active conduct of a trade or business. The $17,500 expense election is reduced dollar-for-dollar for eligible personal property placed in service in excess of $200,000.

Purpose:

This expensing option results in an incentive for investment in equipment, especially for small businesses.

Fiscal Impact:

FY 1996 . . . . $ 330,000
FY 1997 . . . . $ 250,000

13 COMPLETED CONTRACT RULES

MCA 15-31-113

Description:

Long-term construction contracts entered into before March 1, 1986 are allowed to use the completed contract method of accounting. Under this method the contractor reports the gross income from the contract, and deducts any expenses related to it, in the year the contract was completed. The Tax Reform Act of 1986 repealed the completed contract

method of accounting.

Purpose:

This provision provides financial assistance to contractors subject to long-term contracts, and helps to mitigate cash flow problems stemming from long-term contracts.

Fiscal Impact:

FY 1996 . . . . $ 190,000
FY 1997 . . . . $ 190,000

14 EXPENSING OF RESEARCH AND DEVELOPMENT EXPENDITURES

MCA 15-31-113

Description:

Normally, the costs associated with developing or creating a product or other asset must be capitalized over the life of the asset. But in the case of research and development expenditures, taxpayers may chose to fully deduct all expenses in the year in which they occur.

Purpose:

This deduction provides a financial incentive for research and development.

Fiscal Impact:

FY 1996 . . . . $ 180,000
FY 1997 . . . . $ 90,000

15 OTHER DEDUCTIONS FROM FEDERAL INCOME

MCA 15-31-113

Description and Purpose:

There are a number of other deductions from federal income whose tax expenditures are estimated to be less than $100,000. These are:

a) **Expensing Certain Agricultural Multi-Period Production Costs**

Farmers and ranchers may elect to deduct rather than to capitalize, fertilizer costs, costs

of raising livestock, and soil and water conservation expenditures, even if the benefits from these purchases last more than one year. This provides economic assistance to the farming and ranching community.

b) Special Rules for Mining Reclamation Reserves

Normally, accounting rules will not allow a deduction for expenses associated with reclamation activities until the activities are actually performed. However, taxpayers may make a special election to deduct current allocations to a reserve fund dedicated to reclamation activities. The amount allocable in each year is limited to the amount needed to raise the reserve to a level sufficient to reclaim, at current prices, the amount of land thus far disturbed. This provides an incentive to insure funding for reclamation activities will be available at the time reclamation is to be performed.

c) Expensing Costs of Removing Architectural and Transportation Barriers

A taxpayer may elect to treat up to $15,000 of qualified architectural and transportation barrier removal expenses as a current deduction, rather than as a charge to a capital account. This provides financial assistance to help make businesses more accessible to physically challenged persons.

d) Cash Accounting for Non-Agricultural Sectors

Taxpayers may elect the cash method of accounting, rather than the accrual method. Generally, the accrual method is preferred as it matches income and expenses as of the date earned/incurred, rather than received or paid. The difference in taxes on net income between the cash and accrual methods is considered a tax expenditure. This provision of federal tax law provides financial assistance to businesses electing the cash method of accounting.

e) Amortization of Business Start-up Costs

Taxpayers may elect to amortize (expense) qualifying business start-up costs over at least a five year period. Start-up costs include expenditures connected with investigating the creation or acquisition of an active trade or business, and certain other costs of creating an active trade or business. In the absence of this provision, these costs would be included in the original basis of the business and not recovered until the business was sold. This provides an incentive for the formation of new businesses, and mitigates the tax impact on new businesses.

f) Expensing Magazine Circulation Expenditures

Generally, expenses incurred in creating or developing an asset must be capitalized (i.e., included in the value of the asset). However, under this provision of federal law,

publishers of periodicals can deduct expenditures to establish, maintain, and increase circulation. This provides financial assistance to publishers of periodicals.

Combined Fiscal Impact:

FY 1996 . . . . $ 200,000
FY 1997 . . . . $ 200,000

CORPORATION TAX - MONTANA CREDITS

The following corporate tax expenditures (items 16-20) are state-specific credits designed to encourage specific taxpayer behavior and provide financial relief to certain taxpayers.

16 CONTRACTORS' GROSS RECEIPTS CREDIT

MCA 15-50-207

Description:

Contractors are required to pay an additional license fee equal to 1% of the gross receipts from government contracts during the income year for which the license is issued. This additional fee is allowed as a credit against the contractor's corporation license tax liability.

Purpose:

This provision of tax law facilitates the taxation of prime and sub-contractors, while protecting the primary contractor from being taxed twice on the same earnings.

Fiscal Impact:

FY 1996 . . . . $ 1,070,000
FY 1997 . . . . $ 1,010,000

17 INVESTMENT TAX CREDIT

MCA 15-33-123

Description:

Montana allows "small businesses" an investment credit equal to 5% of the federal

investment credit up to a maximum of $500 in any given taxable year. The federal Tax Reform Act of 1986 repealed the federal investment credit. Consequently, the tax expenditures associated with this credit in future years will reflect only the carryforward amounts allowed under current law.

Purpose:

Investment credit provisions are designed to stimulate investment and economic growth.

Fiscal Impact:

FY 1996 . . . . $ 220,000
FY 1997 . . . . $ 220,000

18 RECYCLING CREDIT

MCA 15-32-601 through 15-32-611

Description:

Qualifying taxpayers may claim a credit of 25% of the cost of qualifying property used to collect or process "reclaimable material", or to manufacture a product from reclaimed material, in the year in which the property is purchased.

Purpose:

The purpose of this credit is to provide an incentive to accumulate and process reclaimable materials, reduce the burden on local landfills, and to enhance the quality of the environment.

Fiscal Impact:

FY 1996 . . . . $ 180,000
FY 1997 . . . . $ 200,000

19 MONTANA CAPITAL COMPANY CREDIT

MCA 90-8-202

Description:

Corporations are allowed an income tax credit for investing in certified Montana capital companies. The credit is limited to 50% of the investment up to $150,000 per taxpayer for

regular capital companies, and up to an additional $250,000 for the one qualified Montana small business investment capital company.

Purpose:

Provide an incentive to encourage the formation of venture and equity capital in Montana.

Fiscal Impact:

FY 1996 . . . . $ 190,000
FY 1997 . . . . $ 190,000

20 OTHER TAX CREDITS

MCA 15-32-107, 15-30-163, 15-31-132, 15-31-131, 15-31-125

Description and Purpose:

There are a number of other credits whose tax expenditures are estimated to be less than $100,000. These are:

a) Interest Differential Credit

Electric and natural gas public utilities may install or pay for the installation in dwellings, of energy conservation materials and non-fossil forms of energy generation systems. Occupants of such dwellings then reimburse the utility, including interest, through periodic installments added to their regular utility bills. Utilities are limited to charging 7 percent interest on these installations. Also, financial institutions are allowed to make loans for energy-related installations at a rate not less than 2 percent below the discount rate on 90-day commercial paper.

Utilities and financial institutions are allowed to calculate the difference between interest earned on these loans and installations, and what would have been earned at the prevailing average interest rate for home improvement loans, and apply the difference as a tax credit on corporation license tax returns. This credit provides an incentive for the installation of low-cost conservation materials, and promotes conservation of fossil fuels.

b) College Contribution Credit

Corporations may claim as a credit against their license tax 10 percent of the amount of their contributions to the general endowment funds of the Montana University System foundations, or to the general endowment fund of a Montana private college or its foundation. This credit encourages contributions to Montana colleges and universities.

c) **Employer Health Insurance Credit**

Employers with 20 or fewer employees, may claim a nonrefundable credit of up to $3,000 for expenditures on employee health insurance premiums. The credit may not exceed 50 percent of the premium cost for each employee, and may not be claimed for a period of more than three years. The purpose of this credit is to encourage health insurance coverage for uninsured employees.

d) **Dependent Care Assistance Credit**

Employers are granted a credit for dependent care assistance actually provided to employees, if the assistance is furnished by a registered or licensed day-care provider. The amount of the credit is 20 percent of expenditures up to a maximum credit of $1,250. This provides an incentive for employers to fund dependent care assistance programs, and thus grants financial relief to working parents.

e) **New/Expanded Industry Credit**

New and expanding industries are allowed a tax credit equal to 1% of the total new wages paid in Montana, for the first three years of operation or expansion. Expanding operations must increase total full-time jobs by 30% or more. "New" industry means a corporation engaging in manufacturing for the first time in Montana. This provides an incentive for economic development and job creation.

Combined Fiscal Impact:

FY 1996 . . . . $ 70,000
FY 1997 . . . . $ 70,000

NATURAL RESOURCES TAXES

OVERVIEW AND SUMMARY

Montana statutes provide for metal and micaceous mines license taxes, and coal, oil, and natural gas severance taxes. Tax expenditures identified in this report pertain to all these taxes, except for the micaceous mines license tax.

Coal

The severance tax on coal is expressed as a percentage of the value (contract sales price) of each ton of coal mined. Except for very small producers, the first 20,000 tons of coal mined is exempt from taxation (very small producers may exempt up to 50,000 tons). Tax rates vary depending on the heat content of the coal (measured in BTU units), and on whether the coal is extracted via a surface or underground operation. The vast majority of coal mined in Montana is from surface operations subject to the maximum tax rate of 15 percent, applicable to coal with a BTU value of 7,000 and over. The tax rate for surface mined coal of less heating quality, is 10 percent.

Oil and Natural Gas

State severance taxes on oil and gas production are calculated as a percentage of the gross value of production. Gross value in any month is defined to be total production, less any production used in the operation of the well, times the average wellhead price during the month. The "regular production" state tax rates for oil and gas are 5 percent and 2.65 percent, respectively.

Gas stripper (low production) wells are treated separately. A natural gas stripper well produces 60,000 cubic feet or less per day, on the average. The first 30,000 cubic feet of average daily natural gas production is exempt from the regular state tax (2.65 percent), and the additional stripper well production is taxed at 1.59 percent.

Metal Mines

Persons engaged in or carrying on the business of operating any mine from which gold, silver, copper, lead, or any other metal or precious/semi-precious stones are produced, are subject to the metals mines license tax. This tax possesses the characteristics of a severance tax.

The tax is calculated as a percentage of gross value, where gross value is defined as market value. The tax rate depends on the product type and the total gross value of product. The first $250,000 is exempt from taxation, regardless of product type. Mineral concentrate shipped to a mill, smelter, or reduction facility, is taxed at 1.81 percent. Gold, silver, or any platinum group metal in dore, bullion, or matte form that is shipped to a refinery, is taxed at 1.60

percent.

The following table summarizes the natural resource tax expenditures, which are outlined in more detail in the next section.

SUMMARY OF NATURAL RESOURCE TAX EXPENDITURES

	Tax Expenditure Item	Fiscal Impact (thousands $) FY 1996	FY 1997	Biennium
	Oil State Severance Tax Expenditures (pages 75-76)			
1.	Reduced Rate for Secondary Incremental Production	(see detail below)		
2.	Reduced Rate for Tertiary Incremental Production	(see detail below)		
	Natural Gas State Severance Tax Expenditures (pages 76-77)			
3.	Tax Exemption for Natural Gas Stripper Well Production	1,040	1,080	2,120
4.	Reduced Tax Rate on Natural Gas Stripper Well Production	60	60	120
	Oil Net Proceeds Tax Expenditures (pages 77-79)			
5.	"New" Oil Production Net Proceeds Tax Exemption	570	610	1,180
6.	"New Horizontal Oil Production Net Proceeds Tax Exemption	(see detail below)		
7.	Reduced Rate on Secondary Incremental Production	(see detail below)		
8.	Reduced Rate on Tertiary Incremental Production	(see detail below)		

Natural Gas Net Proceeds Tax Expenditures (page 79)

	Tax Expenditure Item	Fiscal Impact (thousands $) FY 1996	FY 1997	Biennium
9.	"New Gas Production Net Proceeds Tax Exemption	940	970	1,910

Oil Local Government Severance Tax Expenditures (pages 80-81)

10.	Reduced Rate for Oil Production From a Stripper Well	720	720	1,440
11.	Reduced Rate for Secondary Incremental Oil Production	(see detail below)		
12.	Reduced Rate for Tertiary Incremental Production	(see detail below)		

Natural Gas Local Government Severance Tax Expenditures (page 81)

13.	Reduced Rate on Natural Gas Stripper Well Production	1,410	1,450	2,860

Other Natural Resource Tax Expenditures (page 82)

14.	Coal Severance Tax Exemption	140	140	280
15.	Metal Mines License Tax Exemption	110	120	230

NATURAL RESOURCES TAX EXPENDITURES

The following tax expenditures are designed to encourage specific taxpayer behavior and provide financial assistance to certain natural resource taxpayers.

OIL STATE SEVERANCE TAX EXPENDITURES

1 REDUCED RATE FOR SECONDARY INCREMENTAL PRODUCTION

MCA 15-36-101

Description:

Incremental oil production resulting from a secondary recovery project is taxed at a reduced rate of 3% of gross value (instead of 5%). The secondary recovery project must be certified by the Board of Oil and Gas Conservation. The reduced tax rate on incremental production applies to certified production after 12/31/93 and before 1/1/2002.

Purpose:

This reduced rate provides an economic incentive to increase production from wells using alternative recovery systems.

Fiscal Impact:

The fiscal impact for this tax expenditure is unknown and cannot be accurately estimated at the time of this report.

2 REDUCED RATE FOR TERTIARY INCREMENTAL PRODUCTION

MCA 15-36-101

Description:

Incremental oil production resulting from a tertiary recovery project is taxed at a reduced rate of 2% of gross value (instead of 5%). The tertiary recovery project must be certified by the Board of Oil and Gas Conservation. The reduced tax rate on incremental production applies to certified production after 12/31/93 and before 1/1/2002.

Purpose:

This reduced rate provides an economic incentive to increase production from wells using alternative recovery systems.

Fiscal Impact:

The fiscal impact for this tax expenditure is unknown and cannot be accurately estimated at the time of this report.

NATURAL GAS STATE SEVERANCE TAX EXPENDITURES

3 TAX EXEMPTION FOR NATURAL GAS STRIPPER WELL PRODUCTION

MCA 15-36-121 (3)

Description:

The first 30,000 cubic feet of gas produced from a well that produced 60,000 cubic feet or less of natural gas a day during the prior calendar year, is exempt from the severance tax.

Purpose:

This provides an economic incentive to maintain production from stripper wells.

Fiscal Impact:

FY 1996	$ 1,040,000
FY 1997	$ 1,080,000

4 REDUCED TAX RATE ON NATURAL GAS STRIPPER WELL PRODUCTION

MCA 15-36-121

Description:

The normal severance tax rate on the production of natural gas is 2.65%. However, production in excess of 30,000 cubic feet from a well that produced 60,000 cubic feet or less per day during the prior calendar year, is taxed at a reduced rate of 1.59%.

Purpose:

This provides an economic incentive to maintain production from stripper wells.

Fiscal Impact:

FY 1996	$ 60,000
FY 1997	$ 60,000

OIL NET PROCEEDS TAX EXPENDITURES

5 "NEW" OIL PRODUCTION NET PROCEEDS TAX EXEMPTION

MCA 15-23-612

Description:

Oil from a well that qualifies as "new" production is exempt from net proceeds taxes for the first 12 months following the start of production. New production refers to the production of oil from any well that has not produced oil during the 5 years immediately preceding the first month of qualified new production. New production is generally associated with wells drilled after June 30, 1985.

Purpose:

This exemption provides an economic incentive for the exploration, development, and production of oil.

Fiscal Impact:

FY 1996	$ 570,000
FY 1997	$ 610,000

6 "NEW" HORIZONTAL OIL PRODUCTION NET PROCEEDS TAX EXEMPTION

MCA 15-23-612

Description:

Oil from a horizontally-drilled well is exempt from the net proceeds tax for the first 18-months of production.

Purpose:

This exemption provides an incentive for operators to recover oil using horizontal drilling methods that could not otherwise be extracted. The horizontal recovery project must be certified by the Board of Oil and Gas Conservation.

Fiscal Impact:

The fiscal impact for this tax expenditure is unknown and cannot be accurately estimated at the time of this report.

7 REDUCED RATE ON SECONDARY INCREMENTAL PRODUCTION

MCA 15-23-607

Description:

Incremental oil production resulting from a secondary recovery project is taxed at a reduced rate of 5.0% of gross value (instead of 7%). The secondary recovery project must be certified by the Board of Oil and Gas Conservation. The reduced tax rate on incremental production applies to certified production after 12/31/93 and before 1/1/2002.

Purpose:

This reduced rate provides an economic incentive to increase production from wells using alternative recovery systems.

Fiscal Impact:

The fiscal impact for this tax expenditure is unknown and cannot be accurately estimated at the time of this report.

8 REDUCED RATE ON TERTIARY INCREMENTAL PRODUCTION

MCA 15-23-607

Description:

Incremental oil production resulting from a tertiary recovery project is taxed at a reduced rate of 3.3% of gross value (instead of 7%). The tertiary recovery project must be certified by the Board of Oil and Gas Conservation. The reduced tax rate on incremental production applies to certified production after 12/31/93 and before 1/1/2002.

Purpose:

This reduced rate provides an economic incentive to increase production from wells using alternative recovery systems.

Fiscal Impact:

The fiscal impact for this tax expenditure is unknown and cannot be accurately estimated at the time of this report.

NATURAL GAS NET PROCEEDS TAX EXPENDITURES:

9 "NEW" GAS PRODUCTION NET PROCEEDS TAX EXEMPTION

MCA 15-23-612

Description:

Gas from a well that qualifies as "new" production is exempt from net proceeds taxes for the first 12 months following the month in which the gas is placed into a natural gas distribution system. New production refers to the production of gas from any well that has not produced gas during the 5 years immediately preceding the first month of qualified new production. New production is generally associated with wells drilled after June 30, 1985.

Purpose:

This provides an economic incentive for the exploration, development, and production of natural gas.

Fiscal Impact:

FY 1996 . . . . $ 940,000
FY 1997 . . . . $ 970,000

OIL LOCAL GOVERNMENT SEVERANCE TAX EXPENDITURES
(FOR WELLS WHICH BEGAN PRODUCING PRIOR TO 7/1/85)

10 REDUCED RATE FOR OIL PRODUCTION FROM A STRIPPER WELL

MCA 15-36-101

Description:

Stripper wells are defined as oil wells producing an average of 10 barrels or less per day during the previous calendar year. Production from stripper wells is taxed at a reduced rate of 5.0% (instead of 8.4%) of gross value.

Purpose:

This provides an economic incentive to maintain production from stripper wells.

Fiscal Impact:

FY 1996 . . . . $ 720,000
FY 1997 . . . . $ 720,000

11 REDUCED RATE FOR SECONDARY INCREMENTAL OIL PRODUCTION

MCA 15-36-101

Description:

Incremental oil production resulting from a secondary recovery project is taxed at a reduced rate of 5% of gross value (instead of 8.4%). The secondary recovery project must be certified by the Board of Oil and Gas Conservation. The reduced tax rate on incremental production applies to certified production after 12/31/93 and before 1/1/2002.

Purpose:

This reduced rate provides an economic incentive to increase production from wells using alternative recovery systems.

Fiscal Impact:

The fiscal impact for this tax expenditure is unknown and cannot be accurately estimated at the time of this report.

12 REDUCED RATE FOR TERTIARY INCREMENTAL PRODUCTION

MCA 15-36-101

Description:

Incremental oil production resulting from a tertiary recovery project is taxed at a reduced rate of 3.3% of gross value (instead of 8.4%). The tertiary recovery project must be certified by the Board of Oil and Gas Conservation. The reduced tax rate on incremental production applies to certified production after 12/31/93 and before 1/1/2002.

Purpose:

This reduced rate provides an economic incentive to increase production from wells using alternative recovery systems.

Fiscal Impact:

The fiscal impact for this tax expenditure is unknown and cannot be accurately estimated at the time of this report.

NATURAL GAS LOCAL GOVERNMENT SEVERANCE TAX EXPENDITURES

13 REDUCED RATE ON NATURAL GAS STRIPPER WELL PRODUCTION

MCA 15-36-121

Description:

Stripper wells are defined as gas wells producing an average of 60,000 cubic feet or less per day during the previous calendar year. Production from stripper wells is taxed at a reduced rate of 10.0% (instead of 15.25%) of gross value.

Purpose:

This provides an economic incentive to maintain production from stripper wells.

Fiscal Impact:

FY 1996 . . . . $ 1,410,000
FY 1997 . . . . $ 1,450,000

OTHER NATURAL RESOURCE TAX EXPENDITURES

14 COAL SEVERANCE TAX EXEMPTION

MCA 15-35-103 (5)

Description:

Coal producers who mine less than 50,000 tons of coal per year are exempt from severance taxes. If production exceeds 50,000 tons, then only the first 20,000 tons (5,000 tons per quarter) are exempt from severance tax.

Purpose:

This exemption grants economic relief to small producers.

Fiscal Impact:

FY 1996 . . . . $ 140,000
FY 1997 . . . . $ 140,000

15 METAL MINES LICENSE TAX EXEMPTION

MCA 15-37-103

Description and Purpose:

The first $250,000 of production subject to the metal mines license tax is exempt from taxation. This exemption for production below $250,000 in value represents a tax expenditure. This provides economic assistance to small producers of metals and precious/semi-precious stones, and provides an incentive to produce from small mining claims.

Combined Fiscal Impact:

FY 1996 . . . . $ 110,000
FY 1997 . . . . $ 120,000

PROPERTY TAX

OVERVIEW AND SUMMARY

In Montana, the property tax is the primary source of funding for local governments. For any given piece of property the tax base is the product of the market value of the property and its applicable taxable value percentage.

Property tax liability is the product of taxable value (tax base) and the appropriate mill levy in effect for the property. Mills are levied by counties, cities and towns, and school districts. Certain property may be subject to additional mills for special districts (water, sewer, lighting, etc.).

Currently, property may fall into one of 11 classes of property, with taxable value percentages ranging from 0.79 percent to 100 percent. A description of these property classes and their taxable values can be found in the Department of Revenue's *Biennial Report.*

Property tax expenditures arise as a consequence of certain property being exempt from tax, or receiving preferential rate treatment. Generally, preferential rate treatment refers to situations where properties *within the same class* are subject to different taxable value rates.

MCA 15-6-201, and following sections, detail the property exempt from tax. Many types of property are exempt from tax including government property, household goods and furniture, church property, property of certain fraternal organizations and societies, business inventories, certain agricultural commodities, down-hole equipment in oil and gas wells, etc.

Most of these exemptions constitute tax expenditures. However, placing an accurate value on the expenditures associated with these properties is not possible unless the property is appraised. Unfortunately, property not subject to tax is rarely, if ever, appraised. Therefore, tax expenditures associated with most exempt property are not reported here.

The following table summarizes the property tax expenditures outlined in more detail:

SUMMARY OF PROPERTY TAX EXPENDITURES (PAGES 85-88)

	Tax Expenditure Item	Fiscal Impact (thousands $) FY 1996	FY 1997	Biennium
1.	Business Inventory Exemption	(see detail below)		
2.	Certain Agricultural Products Tax Exemption	(see detail below)		
3.	Reduced Rates for Low-income Residential Property	2,000	2,000	4,000
4.	Reduced Rate for "New" or "Expanding" Industrial Property (Local-Option Incentive)	1,400	1,400	2,800
5.	Reduced Rate for Remodeling of Buildings and Structures	70	70	140
6.	Reduced Rate for "New Industrial" Property	Minimal	Minimal	Minimal

PROPERTY TAX EXPENDITURES

The following property tax expenditures are the result of Montana legislative actions. They encourage specific taxpayer behavior as well as provide financial assistance to certain taxpayers.

1 EXEMPTION FOR BUSINESS INVENTORIES

MCA 15-6-202 (5)

Description:

Inventories held in the regular course of business are exempt from property taxation (SB 283, 1981 Session).

Purpose:

This provides financial relief to existing businesses, and provides a financial incentive for the development of new businesses.

Fiscal Impact:

The original 1981 fiscal note, based on total taxable valuation for business inventories of $33 million, and a statewide average mill levy of 226 mills, placed the annual revenue loss at $7,460,000. Increases in mill levies and in market values since that time would produce larger revenue losses today. However, due to severe data limitations, no precise estimate of the revenue loss due to exempting business inventories is currently available.

2 CERTAIN AGRICULTURAL PRODUCTS TAX EXEMPTION

MCA 15-6-207

Description:

Producer-held grain in storage, swine which have not attained the age of 6 months, other livestock which have not attained the age of 24 months, poultry, and bees are exempt from property taxes.

Purpose:

This exemption provides economic relief to Montana's agricultural community.

Fiscal Impact:

Since this property is totally exempt from taxation and therefore not assessed, no new data exists for updating an estimate of this expenditure. Factors that would impact this expenditure include changes in mill levies and fluctuations in commodity values. The 1989 *Tax Expenditure Report* estimated this expenditure to be $2,200,000 for Fiscal Years 1990 and 1991.

3 REDUCED RATES FOR LOW-INCOME RESIDENTIAL PROPERTY

MCA 15-6-134, and 15-6-144

Description:

Montana property tax statutes provide for a partial abatement, based on total income, that reduces the taxable valuation rate applicable to residential real property. Taxable value rates are reduced according to a ten-bracket schedule for single households with less than $13,512 income (1995 assessment), and married couple households with less than $16,214 (1995 assessment). The income levels used in the rate reduction table are adjusted annually for inflation.

The reduced taxable value rate applies to the first $80,000 of the market value of residential land and improvements, including trailers/mobile homes used as residences (Class 4).

Purpose:

This provides financial relief to low-income households.

Fiscal Impact:

FY 1996 . . . . $ 2,000,000
FY 1997 . . . . $ 2,000,000

4 REDUCED RATE FOR "NEW" OR "EXPANDING" INDUSTRIAL PROPERTY (LOCAL-OPTION INCENTIVE)

MCA 15-24-1401, and 1402

Description:

After approval by separate resolution for each project, local governments may reduce taxable valuations of "new" or "expanding" industries 50% in each of the first five years following the issuance of a construction permit. After that time, the taxable valuation rises in equal

increments each succeeding year until full valuation is reached in the 10th year. This incentive does not apply to mills levied by the state.

"Expansion" means that the industry has added at least $50,000 worth of qualifying improvements or modernized process; "new" means that the industry is new to the jurisdiction and has added at least $125,000 worth of qualifying improvements or modernized processes to the jurisdiction.

There are no limitations on the type of industry that may qualify for this incentive.

Purpose:

Provide an economic incentive for the development of new industry in Montana.

Fiscal Impact:

FY 1996 . . . . $ 1,400,000
FY 1997 . . . . $ 1,400,000

5 REDUCED RATE FOR REMODELING OR REBUILDING OF STRUCTURES (LOCAL-OPTION INCENTIVE)

MCA 15-24-1501

Description:

Remodeling, reconstruction, or expansion of existing buildings or structures which increases their taxable value by at least 2.5% may receive a reduced tax rate for five years following construction, through local government approval by separate resolution for each project.

Tax rates are set at zero during construction, at 20% of normal during the first year following construction, and increase by 20% in each succeeding year until full valuation is reached in the fifth year following construction. All existing buildings and structures may apply for this benefit.

Purpose:

This abatement provides an incentive to add long-term taxable valuation to local jurisdictions, while allowing the property owner to phase-in the increased tax liability.

Fiscal Impact:

FY 1996 . . . . $ 70,000
FY 1997 . . . . $ 70,000

6 REDUCED RATE FOR "NEW INDUSTRIAL" PROPERTY

MCA 15-6-135

Description:

New industrial property, including land, buildings, machinery, and fixtures, is eligible for a reduced taxable valuation rate of 3 percent for the first three years of operations. Normal taxable value rates for industrial property include 3.86 percent for land and buildings, and 9 percent for manufacturing equipment.

New industry refers to new industrial endeavors (as opposed to expansions, reorganizations, or mergers), and generally includes only manufacturing, mining, and other industries earning at least 50 percent of their annual gross income from out-of-state sources.

Purpose:

This is an economic incentive for the development of new industry in Montana.

Fiscal Impact:

FY 1996 . . . . Minimal
FY 1997 . . . . Minimal

APPENDIX A

INDIVIDUAL INCOME TAX EXPENDITURE ITEMS - BY INCOME BRACKET

House Bill 387 (1987), the legislation authorizing the Department of Revenue to produce a tax expenditure report, specifically required that tax expenditures must be related to the income of taxpayers, whenever such information is available.

This information is available for specific individual income tax expenditure items that are captured on department computer files. Specifically, tax expenditures, by income bracket, are available for Montana-specific reductions to income, and itemized deductions.

Totals for the tax expenditures in Appendix A are for full-year residents only, whereas the expenditures in the main body of this report include out-of-state and part-year residents as well.

The following tables show the distributions of tax expenditures across income brackets that represent decile groupings. Each decile group includes one-tenth of all households filing income tax returns. The first decile group includes households with the very lowest incomes, while the tenth decile group includes households having the highest incomes.

The decile groupings are based on actual 1993 incomes, but the tax expenditures are those projected to calendar year 1995. The decile groupings and their associated total income brackets for 1993 are as follows:

Decile Group	Income Bracket
1	$ 0 - $ 3,374
2	$ 3,374 - $ 6,685
3	$ 6,685 - $10,385
4	$10,385 - $14,507
5	$14,507 - $19,400
6	$19,400 - $25,465
7	$25,465 - $32,962
8	$32,962 - $42,436
9	$42,436 - $57,362
10	$57,362 +

REDUCTIONS OF INCOME
(Tax Year 1995)

IRAs, Keoghs, and Self-Emp. Deds. / Capital Gains Exclusion

Decile Group	IRAs, Keoghs, and Self-Emp. Deds. # of Households	Tax Expenditure	Percent	Capital Gains Exclusion # of Households	Tax Expenditure	Percent
1	1,320	37,336	0.30%	0	0	0.00%
2	2,640	34,644	0.28%	0	0	0.00%
3	3,520	68,926	0.55%	110	1,514	0.19%
4	4,290	137,652	1.10%	0	0	0.00%
5	6,537	429,032	3.43%	274	6,519	0.83%
6	6,385	584,917	4.68%	466	21,566	2.76%
7	9,108	1,086,281	8.69%	492	18,140	2.32%
8	9,132	1,245,465	9.96%	418	38,106	4.87%
9	9,089	1,829,554	14.63%	719	133,800	17.11%
10	11,927	7,051,543	56.39%	1,013	562,276	71.91%
Total	63,948	$12,505,350	100.00%	3,492	$781,921	100.00%

Elderly Interest Exclusion / Exempt Retirement Income

Decile Group	Elderly Interest Exclusion # of Households	Tax Expenditure	Percent	Exempt Retirement Income # of Households	Tax Expenditure	Percent
1	0	0	0.00%	220	7,260	0.13%
2	880	11,433	0.60%	2,750	117,307	2.04%
3	4,510	111,666	5.83%	2,970	219,366	3.81%
4	5,500	146,541	7.65%	6,820	798,916	13.86%
5	4,914	177,333	9.26%	6,018	1,084,776	18.82%
6	5,215	221,397	11.56%	6,201	1,287,858	22.35%
7	3,776	234,686	12.25%	3,677	910,067	15.79%
8	3,502	251,081	13.11%	1,994	459,634	7.98%
9	3,679	297,381	15.52%	2,163	492,207	8.54%
10	4,341	464,210	24.23%	1,420	385,570	6.69%
Total	36,317	$1,915,728	100.00%	34,233	$5,762,961	100.00%

REDUCTIONS OF INCOME
(Tax Year 1995)

Unemployment Compensation

Decile Group	# of Households	Tax Expenditure	Percent
1	0	0	0.00%
2	1,650	39,723	1.53%
3	2,310	100,597	3.88%
4	3,850	250,833	9.67%
5	3,223	299,542	11.54%
6	5,060	544,759	20.99%
7	3,372	420,888	16.22%
8	3,494	407,161	15.69%
9	2,506	325,739	12.55%
10	1,240	205,595	7.92%
Total	26,705	$2,594,837	100.00%

Tip Income

Decile Group	# of Households	Tax Expenditure	Percent
1	220	3,431	0.64%
2	990	31,394	5.81%
3	990	57,070	10.56%
4	990	86,140	15.95%
5	727	163,858	30.33%
6	369	32,145	5.95%
7	330	26,341	4.88%
8	530	101,013	18.70%
9	222	32,620	6.04%
10	93	6,205	1.15%
Total	5,461	$540,217	100.00%

Other Reductions

Decile Group	# of Households	Tax Expenditure	Percent
1	110	907	0.01%
2	660	23,089	0.14%
3	1,870	159,466	0.93%
4	2,200	1,257,477	7.36%
5	2,464	175,753	1.03%
6	6,309	1,021,426	5.98%
7	10,082	1,725,840	10.10%
8	13,431	4,092,971	23.95%
9	16,107	3,231,318	18.91%
10	17,725	5,398,271	31.59%
Total	70,958	$17,086,518	100.00%

ITEMIZED DEDUCTIONS
(Tax Year 1995)

Medical Deductions

Decile Group	# of Households	Tax Expenditure	Percent
1	0	0	0.00%
2	1,320	27,126	0.30%
3	5,060	271,401	2.96%
4	5,940	358,138	3.90%
5	7,033	673,534	7.34%
6	8,018	987,475	10.76%
7	9,366	1,439,130	15.68%
8	9,938	1,517,058	16.53%
9	10,658	1,978,692	21.56%
10	8,487	1,924,571	20.97%
Total	65,820	$9,177,125	100.00%

Long-Term Care Insurance

Decile Group	# of Households	Tax Expenditure	Percent
1	0	0	0.00%
2	0	0	0.00%
3	220	5,498	2.09%
4	330	9,287	3.53%
5	384	26,728	10.15%
6	246	18,903	7.18%
7	220	12,819	4.87%
8	347	42,636	16.19%
9	435	54,971	20.87%
10	296	92,539	35.14%
Total	2,478	$263,381	100.00%

Federal Income Taxes Paid

Decile Group	# of Households	Tax Expenditure	Percent
1	0	0	0.00%
2	330	2,380	0.00%
3	2,310	89,596	0.09%
4	5,280	203,969	0.20%
5	8,332	521,664	0.52%
6	13,989	1,333,155	1.34%
7	18,812	3,164,578	3.17%
8	25,393	7,297,181	7.32%
9	29,791	14,408,040	14.45%
10	31,986	72,666,151	72.89%
Total	136,223	$99,686,714	100.00%

Real Estate, Personal Property Taxes

Decile Group	# of Households	Tax Expenditure	Percent
1	110	1,470	0.01%
2	1,210	17,810	0.13%
3	2,640	50,801	0.38%
4	6,050	183,837	1.37%
5	8,373	361,876	2.69%
6	12,554	653,758	4.86%
7	15,894	1,078,213	8.01%
8	22,433	2,045,282	15.20%
9	27,011	3,150,999	23.42%
10	29,241	5,910,951	43.93%
Total	125,516	$13,454,997	100.00%

ITEMIZED DEDUCTIONS
(Tax Year 1995)

Decile Group	Motor Vehicle Taxes: # of Households	Motor Vehicle Taxes: Tax Expenditure	Motor Vehicle Taxes: Percent	Home Mortgage Interest: # of Households	Home Mortgage Interest: Tax Expenditure	Home Mortgage Interest: Percent
1	0	0	0.00%	0	0	0.00%
2	0	0	0.00%	550	28,089	0.09%
3	1,210	7,694	0.37%	1,540	68,713	0.23%
4	3,190	28,113	1.33%	2,860	290,389	0.98%
5	4,522	40,882	1.94%	4,628	513,559	1.73%
6	7,889	113,427	5.38%	8,025	1,253,113	4.21%
7	11,340	180,829	8.58%	11,521	2,289,849	7.70%
8	16,160	363,116	17.23%	17,594	4,857,487	16.33%
9	19,774	528,936	25.10%	21,189	7,313,755	24.59%
10	19,271	844,577	40.07%	23,032	13,133,298	44.15%
Total	83,356	$2,107,574	100.00%	90,939	$29,748,252	100.00%

Decile Group	Deductible Investment Interest: # of Households	Deductible Investment Interest: Tax Expenditure	Deductible Investment Interest: Percent	Charitable Contributions: # of Households	Charitable Contributions: Tax Expenditure	Charitable Contributions: Percent
1	0	0	0.00%	110	254	0.00%
2	0	0	0.00%	550	4,537	0.03%
3	0	0	0.00%	2,420	52,438	0.34%
4	550	16,557	0.78%	4,070	115,917	0.75%
5	535	27,292	1.28%	6,785	235,771	1.52%
6	356	23,845	1.12%	10,530	531,792	3.42%
7	729	108,789	5.09%	14,218	976,137	6.28%
8	948	129,676	6.07%	20,503	1,650,558	10.62%
9	1,278	166,242	7.78%	25,062	2,472,842	15.91%
10	3,674	1,663,341	77.88%	29,426	9,506,782	61.15%
Total	8,070	$2,135,742	100.00%	113,674	$15,547,028	100.00%

ITEMIZED DEDUCTIONS
(Tax Year 1995)

Child and Dependent Care

Decile Group	# of Households	Tax Expenditure	Percent
1	0	0	0.00%
2	0	0	0.00%
3	110	524	1.83%
4	0	0	0.00%
5	356	17,113	59.85%
6	151	1,101	3.85%
7	41	1,986	6.95%
8	56	950	3.32%
9	94	4,555	15.93%
10	23	2,366	8.27%
Total	831	$28,595	100.00%

Casualty and Theft Losses

Decile Group	# of Households	Tax Expenditure	Percent
1	0	0	0.00%
2	0	0	0.00%
3	0	0	0.00%
4	0	0	0.00%
5	0	0	0.00%
6	41	5,098	4.25%
7	28	2,048	1.71%
8	69	15,979	13.33%
9	44	43,673	36.43%
10	111	53,068	44.27%
Total	293	$119,866	100.00%

Miscellaneous Deductions

Decile Group	# of Households	Tax Expenditure	Percent
1	0	0	0.00%
2	440	2,608	0.04%
3	330	9,584	0.15%
4	990	41,649	0.64%
5	986	63,715	0.97%
6	2,583	299,280	4.58%
7	4,372	724,443	11.08%
8	6,932	1,091,456	16.69%
9	7,651	1,395,714	21.34%
10	8,876	2,910,431	44.51%
Total	33,160	$6,538,880	100.00%

250 copies of this public document were published at an estimated cost of $3.40 per copy, for a total cost of $850.00, which includes $850.00 for printing and $.00 for distribution.